XIAOMI CORPORATION

(A company controlled through weighted voting rights and incorporated in the Cayman Islands with limited liability)

2018 ANNUAL REPORT

Stock Code: 1810

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Shareholders may at any time choose to change their choice of means of receipt (in printed form or by electronic means through the Company's website) and language (in English only, in Chinese only or in both Chinese and English) of all future corporate communications from the Company by sending reasonable prior notice in writing by post to the Hong Kong Share Registrar at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong or by email at xiaomi.ecom@computershare.com.hk.

CONTENTS

We relentlessly build amazing products

with honest prices to let everyone in the world

enjoy a better life through innovative technology

OPEN LETTER FROM OUR CHAIRMAN

Dear investors and friends,

We recently released our full year financial results for the year ended December 31, 2018. Our results demonstrated strong growth in our business and I would like to share why we are confident of our continued success, even in an uncertain and challenging macro environment.

Our reorganizations in 2018 have laid the foundation for Xiaomi's future growth

Our courage and confidence to face challenges head on have been and will continue to be our most valuable attribute.

In 2018, despite the overall decline of global smartphone shipments and the backdrop of Sino-US trade talks, we are proud to say that Xiaomi has maintained robust growth.

In the year ended December 31, 2018, Xiaomi achieved RMB174.9 billion in revenue, an increase of 53% over the previous year, and RMB8.6 billion in adjusted net profit, an increase of 60% over the previous year. Detailed financial performance metrics can be found in our annual report. We believe Xiaomi's results surpassed market expectations.

We made major reorganizations to our company in order to achieve these numbers. In doing so, we also laid the foundation for our strategy over the next five years. These reorganizations were far-reaching and a major undertaking to execute. Even more so than our financial results, I believe that these reorganizations were our most important achievements in 2018.

After several years of planning and preparation, we started reorganizing our company after our IPO in 2018. Firstly, we established the Organization Department and the Strategic Advisory Department to strengthen the executive decision making process of the company and to ensure that we make the right long-term decisions.

At the same time, we streamlined various large business departments into smaller business units, including our internet services and other businesses. We appointed and promoted a number of experienced and energetic young managers to run these businesses. In short, this was a year in which we comprehensively upgraded the management of Xiaomi.

In 2018, we revealed our vision of "AIoT". AIoT has long been recognized as the next major opportunity in the new "super Internet" era. In the past few years, investments in the AI and IoT sectors have earned us a significant competitive advantage in these fields. In order to capitalize on this advantage, we upgraded the company's core strategy to a "Dual-Engine Strategy" of "Smartphone + AIoT". In the next five years, we will go all-in on AIoT, with a plan to invest at least RMB10 billion in this area.

As for our smartphone business, in the fourth quarter of 2018, we successfully developed our multi-brand strategy and proactively adjusted our product portfolio and launch schedules. For our major brands, Xiaomi and Redmi, we released brand new upgraded products with great success in early 2019. Redmi Note 7 shipped more than 1 million units in less than a month, and the supply of our newest flagship product, the Mi 9 series, is also expected to be more than 1.5 million units by the end of March 2019.

Today, we are already very close to the widespread adoption of 5G. We expect that the surge in demand for new 5G compatible smartphones will present us with tremendous opportunities. Xiaomi continues to build a solid foundation for innovation, quality and supply management in the 5G era, and we have also increased our R&D investment every year to help us remain at the forefront of cutting-edge technology. We believe we are well positioned to reach new heights in the new era.

We continued to invest heavily in R&D, and have increased the scale of our engineering team. Today, we have built a team of over 7,000 talented engineers. In the past year, Xiaomi's investment in R&D was around RMB5.8 billion, an increase of 83% compared to the previous year, achieving a compounded annual growth rate of 66% over the past three years. This is an outstanding achievement for a startup founded less than nine years ago. As you can see from our results, our resolute investment in research and technology has provided a strong foundation for our rapid growth.

Implementing the major changes mentioned above while maintaining rapid growth is not an easy task, as it requires tens of thousands of people to work cohesively together with courage and determination. Today we are pleased to report to you that Xiaomi is firmly on track to exceed the expectations we have set for ourselves.

The changes that we have implemented to date have enabled us to stay true to our values, develop our organizational structure more efficiently, and expand and diversify our talent pool. They have also enabled us to implement our multi-brand strategy, refine our product positioning and launch cycles, and balance and diversify our business portfolio.

The impact of our reorganizations will continue to reverberate throughout the company, changing Xiaomi for the better, so that we can continue to deliver our values to the world. This is the source of our continued confidence.

OPEN LETTER FROM OUR CHAIRMAN

Xiaomi is determined to strive for long-term success

Our successful IPO marks only the beginning for us. We have shifted our focus towards the second phase of our entrepreneurial journey.

Xiaomi's primary goal is to use the "Internet business model" to enhance the efficiency of traditional businesses. We know this is not an easy endeavor. We believe it will take time before we can accomplish this. **Therefore, striving for long-term success is our only choice.**

We are confident because our pioneering business model has already tremendously improved the efficiency of many industries we have entered. We are continuously striving to improve our efficiency in production and distribution, and to create amazing products with honest prices to our users. We are very efficient, with operating expenses (excluding one-off share-based compensation) of less than 10% of revenue in 2018.

From the Ford Model T to the rapid adoption of PCs, from Walmart to Costco, history shows that more efficient businesses tend to win over time. A company that truly achieves world-class efficiency will have the ability to navigate through economic cycles, seize new opportunities emerging in the industry, and maintain sound, long-term operational performance.

We believe strongly in our mission to relentlessly build amazing products with honest prices to let everyone in the world enjoy a better life through innovative technology. In order to ensure that we stay true to our mission, our board of directors passed a special resolution before our IPO last year. According to the resolution, we pledged to our existing and potential users that the overall net profit margin of Xiaomi's hardware business will never exceed 5%.

Today, we can proudly state that for our first full-year financial results, Xiaomi's hardware business net margin in the year ended December 31, 2018 was positive and less than 1%.

This is extremely encouraging for us. Our achievements prove that the interests of our users and shareholders can be in harmony with one another. In 2018, we stayed true to our mission of providing "amazing products with honest prices." We continued to sell products at close to cost, while the average selling price of our smartphones and net profit continued to increase.

We firmly believe that whoever is willing to fight for the fundamental interests of the broadest base of users will eventually win in the market. We will continue to listen to our users and improve our products and services. We may forego a small amount of one-time hardware profit, but we will only become stronger with the passage of time.

We are very confident about the future growth of Xiaomi and our open global ecosystem.

Time is on our side, and so we will not waver in our journey towards long-term success

Xiaomi's ambition is to improve the lives of billions of people around the world. Trying to maximize the number of people that we can serve while also maintaining high efficiency is not easy, and there are still many skeptics. When we first founded Xiaomi, I expected that it would take at least 15 years for Xiaomi's business model to be fully understood by the public. Fortunately, time has proven to be our friend, and we are confident that it will remain so. We believe we will improve with each week, month, quarter and year that passes.

Thank you for your trust, support and encouragement. To invest in Xiaomi is to invest in improving the lives of billions of people around the world. To believe in Xiaomi is to believe in the power of innovation, in that good products do not have to be expensive products, and in that efficiency and honest pricing will eventually win.

It may be a long and arduous journey, but we are confident that as long as we persist, we will eventually succeed. Xiaomi will stay the course, and maybe when we look back one day in the distant future, the difficulties we face along the way will be footnotes in the story of our success.

Lei Jun
Chairman
March 19, 2019

CORPORATE INFORMATION

Board of Directors

Executive Directors

Lei Jun (雷軍)*(Chairman of the Board)*
Lin Bin (林斌)

Non-Executive Directors

Koh Tuck Lye (許達來)
Liu Qin (劉芹)

Independent Non-Executive Directors

Chen Dongsheng (陳東升)
Lee Ka Kit (李家傑)
Wong Shun Tak (王舜德)

Audit Committee

Wong Shun Tak (王舜德)*(Chairman)*
Chen Dongsheng (陳東升)
Koh Tuck Lye (許達來)

Remuneration Committee

Chen Dongsheng (陳東升)*(Chairman)*
Lei Jun (雷軍)
Wong Shun Tak (王舜德)

Nomination Committee

Lee Ka Kit (李家傑)*(Chairman)*
Lin Bin (林斌)
Wong Shun Tak (王舜德)

Corporate Governance Committee

Chen Dongsheng (陳東升)*(Chairman)*
Lee Ka Kit (李家傑)
Wong Shun Tak (王舜德)

Joint Company Secretaries

Lin Steve (林冠男)
So Ka Man (蘇嘉敏)

Authorized Representatives

Lin Bin (林斌)
So Ka Man (蘇嘉敏)

Auditor

PricewaterhouseCoopers
Certified Public Accountants

Registered Office

Maples Corporate Services Limited
PO Box 309
Ugland House
Grand Cayman, KY1-1104
Cayman Islands

Head Office and Principal Place of Business in Mainland China

Rainbow City Office Building
68 Qinghe Middle Street
Haidian District
Beijing
The People's Republic of China

Principal Place of Business in Hong Kong

Level 54, Hopewell Centre
183 Queen's Road East
Hong Kong

Hong Kong Legal Advisor

Skadden, Arps, Slate, Meagher & Flom
42/F, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

Compliance Advisor

Guotai Junan Capital Limited
27/F, Low Block
Grand Millennium Plaza
181 Queen's Road Central
Hong Kong

Hong Kong Share Registrar

Computershare Hong Kong Investor Services Limited
Shops 1712–1716, 17th Floor
Hopewell Centre
183 Queen's Road East
Wan Chai
Hong Kong

Principal Share Registrar and Transfer Office

Maples Fund Services (Cayman) Limited
PO Box 1093, Boundary Hall
Cricket Square
Grand Cayman, KY1-1102
Cayman Islands

Principal Banker

China Merchants Bank, Beijing Branch, Shouti Sub-branch

Stock Code

1810

Company Website

www.mi.com

FOUR-YEAR FINANCIAL SUMMARY

Condensed consolidated statements of comprehensive income

	Year ended December 31,			
	2018 RMB'000	2017 RMB'000	2016 RMB'000	2015 RMB'000
Revenue	**174,915,425**	114,624,742	68,434,161	66,811,258
Gross profit	**22,191,939**	15,154,205	7,249,355	2,699,933
Operating profit	**1,196,472**	12,215,467	3,785,064	1,372,670
Profit/(loss) before income tax	**13,927,124**	(41,829,352)	1,175,509	(7,472,511)
Profit/(loss) for the year	**13,477,747**	(43,889,115)	491,606	(7,627,030)
Profit/(loss) attributable to owners of the Company	**13,553,886**	(43,826,016)	553,250	(7,581,295)
Total comprehensive income/(loss) for the year	**11,921,632**	(35,994,749)	(6,307,155)	(13,136,127)
Total comprehensive income/(loss) attributable to owners of the Company	**11,989,243**	(35,922,124)	(6,254,475)	(13,098,817)
Non-IFRS Measure: Adjusted net profit/(loss) (unaudited)	**8,554,548**	5,361,876	1,895,657	(303,887)

Condensed consolidated balance sheets

	As of December 31,			
	2018 RMB'000	2017 RMB'000	2016 RMB'000	2015 RMB'000
Assets:				
Non-current assets	**39,215,389**	28,731,300	20,129,283	14,184,010
Current assets	**106,012,561**	61,138,461	30,636,318	24,952,527
Total assets	**145,227,950**	89,869,761	50,765,601	39,136,537
Equity and liabilities:				
Equity attributable to owners of the Company	**71,322,985**	(127,272,361)	(92,191,670)	(86,714,478)
Non-controlling interests	**(72,856)**	61,670	133,795	76,170
Total equity	**71,250,129**	(127,210,691)	(92,057,875)	(86,638,308)
Non-current liabilities	**12,037,663**	169,947,781	116,760,214	109,310,565
Current liabilities	**61,940,158**	47,132,671	26,063,262	16,464,280
Total liabilities	**73,977,821**	217,080,452	142,823,476	125,774,845
Total equity and liabilities	**145,227,950**	89,869,761	50,765,601	39,136,537

Year ended December 31, 2018

Revenue
174.9
billion

Non-IFRS Measure:
Adjusted net profit
8.6
billion

MIUI MAU
242.1[1]
million

Connected
IoT devices
150.9[2]
million units

Year-on-year growth rate

Revenue
52.6%

Non-IFRS Measure:
Adjusted net profit
59.5%

Internet services
revenue
61.2%

International
revenue
118.1%

Note:

(1) MIUI MAU in December 2018.

(2) Connected IoT devices as of December 31, 2018, excluding smartphones and laptops.

CHAIRMAN'S STATEMENT

Dear Shareholders,

I am pleased to present our annual report for the year ended December 31, 2018 to the shareholders.

Business Review and Outlook

OVERALL FINANCIAL PERFORMANCE	SMARTPHONES	IoT AND LIFESTYLE PRODUCTS
INTERNET SERVICES	INTERNATIONAL MARKETS	STRATEGIC UPDATE

1. Overall financial performance

For the year ended December 31, 2018, we achieved strong revenue growth across all our business segments. We recorded RMB174.9 billion in revenue, representing a year-on-year increase of 52.6%. Adjusted net profit grew by 59.5% year-on-year to RMB8.6 billion. According to IDC Consulting (Beijing) Ltd. ("**IDC**"), our smartphone shipments were ranked fourth in the world during the year ended December 31, 2018. The number of connected IoT devices (excluding smartphones and laptops) on our IoT platform has reached approximately 150.9 million units, a year-on-year increase of 193.2%, solidifying our leading position in the market. Our AI assistant "小愛同學" had been installed and activated on more than 100 million smart devices as of December 31, 2018 and had over 38.8 million monthly active users ("**MAU**") in December 2018. Our internet services segment recorded year-on-year growth of 61.2% and contributed RMB16.0 billion in revenue.

2. Smartphones

Our smartphones segment recorded approximately RMB113.8 billion in revenue for the year ended December 31, 2018, representing an increase of 41.3% over the previous year. Compared with the 4.1% year-on-year decline of shipments in the global smartphone market, according to IDC, our smartphone sales volume for the year ended December 31, 2018 reached 118.7 million units, representing an increase of 29.8% over the previous year. We are one of a few companies in the industry that maintained high growth in 2018.

During the year ended December 31, 2018, we successfully executed our strategy to continue to strengthen our market position in the mid- to high-end range smartphone market in mainland China. We launched several flagship smartphones such as *Mi 8* and *Mi MIX 3*, which enjoyed widespread popularity. During the year ended December 31, 2018, the revenue from our mid- to high-end models has increased compared with the previous year. In the fourth quarter of 2018, the revenue generated by smartphones sold for RMB2,000 or more accounted for 31.8% of the total revenue of the smartphones segment. For the year ended December 31, 2018, our smartphones revenue in mainland China continued to grow year-on-year, driven by the increase of our smartphones average selling price ("**ASP**"). The ASP of our smartphones in mainland China increased by 17.0% year-on-year. As we shipped increasingly more smartphones in developed markets, the ASP of our smartphones in international markets also recorded a year-on-year 9.7% growth. We continued to focus on innovation with increasing investment in smartphone R&D and achieved great progress. Taking camera as an example, our new flagship smartphone *Mi 9*, launched in February 2019, achieved a DxOMark score of 107 for its rear camera, ranking top three globally at the time of launch. It also achieved a DxOMark score of 99 for the video category, which is the highest among all smartphones at the time of launch. We are also one of the early movers in 5G, launching our first 5G smartphone, *Mi MIX 3 5G*, at World Mobile Congress in February 2019.

3. IoT and lifestyle products

During the year ended December 31, 2018, revenue of the IoT and lifestyle products segment increased by 86.9% to RMB43.8 billion over the previous year.

2018 was the year when Xiaomi's large home appliances emerged from a nascent vertical to a robust business unit. During the year ended December 31, 2018, the global shipments of our smart TVs was 8.4 million units, representing a 225.5% year-on-year growth. We also entered the white goods market, launching the *Mi Air Conditioner* and the *Mi Washing Machine* in July and December 2018, respectively.

During the year ended December 31, 2018, we achieved outstanding sales performances across multiple product categories. In addition to smart TVs and laptops, our ecosystem products such as *Mi Band*, *Mi Electric Scooter* and *Mi Robot Vacuum Cleaner* experienced robust sales growth. Our *Mi Robot Vacuum Cleaner* ranked second in terms of

CHAIRMAN'S STATEMENT

shipments in mainland China during the year ended December 31, 2018. According to IDC, Xiaomi was ranked second in terms of wearables shipments across the world in the fourth quarter of 2018. During the year ended December 31, 2018, we received 43 international industrial design awards, including iF Design Awards, Red Dot Awards, International Design Excellence Awards, Good Design Awards, and Design for Asia Awards. Two such accolades went to our *Mi Sphere Camera* which was awarded the iF Gold Award and our *Mi Rearview Mirror* which was awarded the Red Dot: Best of the Best award. These awards are further testament to our exceptional design capabilities and craftsmanship.

2018 marked the commencement of our overseas IoT business expansion. We launched our smart TVs in India in February 2018 and were ranked first in terms of online TV shipments in this market during the year ended December 31, 2018.

As of December 31, 2018, there were about 2.3 million users who own more than five Xiaomi IoT devices (excluding smartphones and laptops), representing a 16.2% quarter-on-quarter growth and a 109.5% year-on-year growth.

4. Internet services

Revenue from our internet services segment grew 61.2% year-on-year to RMB16.0 billion for the year ended December 31, 2018. Advertising revenue grew by 79.9% year-on-year to RMB10.1 billion, primarily driven by continuous optimization of our recommendation algorithm, and users' increasing engagement with our internet services. Revenue from our internet value-added services also grew 36.7% year-on-year to RMB5.9 billion, of which revenue from gaming accounted for RMB2.7 billion, a 7.3% year-on-year increase. Revenue from our other internet value-added services grew 79.9% year-on-year to RMB3.2 billion, primarily due to an increase in revenue contribution from our internet finance business and Youpin e-commerce platform.

In the fourth quarter of 2018, over 30% of our internet services revenue was from internet services outside of advertising and gaming from China smartphones. We believe this reflects increasing diversification of our internet services revenue. Our overseas internet services revenue accounted for 6.3% of all internet services revenue in the fourth quarter of 2018, growing 1,295.6% year-on-year. We continued to enhance our overseas internet services and launched our popular internet services in international markets. For example, we launched our video, app store and news feed services in India and Indonesia during the year ended December 31, 2018. The MAU of our smart TVs and *Mi Box* achieved 55.3% year-on-year growth, reaching 18.6 million in December 2018. TV internet services revenue accounted for 8.2% of our total internet services revenue in the fourth quarter of 2018, with a 119.1% year-on-year increase. The revenue from our internet finance business and the Youpin e-commerce platform accounted for 11.9% and 4.1% of total revenue of internet services in the fourth quarter of 2018, with year-on-year growth rates of 80.5% and 427.6%, respectively.

As a result of our large, diverse and highly-engaged user base, we effectively expanded our internet services during the year ended December 31, 2018. Through selling more smartphones, diversifying product and content, improving customer experience, and continuously optimizing the recommendation algorithm, we attracted more active users across our apps and achieved an increase of the overall average revenue per MIUI user ("**ARPU**"). The MAU of MIUI increased 41.7% from 170.8 million in December 2017 to 242.1 million in December 2018. ARPU for internet services increased from RMB57.9 for the year ended December 31, 2017 to RMB65.9 for the year ended December 31, 2018.

5. International markets

We achieved great success in our business expansion in international markets for the year ended December 31, 2018. Our revenue from international markets grew 118.1% year-on-year to RMB70.0 billion during the year ended December 31, 2018, which accounted for 40.0% of our total revenue for the same period, compared with 28.0% for the year ended December 31, 2017.

International shipments of our smartphones continued to demonstrate strong growth momentum. According to Canalys, our smartphones achieved the number one market share position by shipments for six consecutive quarters in India, with year-on-year growth of 59.6% for the year ended December 31, 2018. In Indonesia, we were ranked second in terms of smartphone shipments for the year ended December 31, 2018, with year-on-year growth of 299.6%. Our smartphone shipments for Western Europe grew 415.2% year-on-year and we were ranked fourth in terms of smartphone shipments for the year ended December 31, 2018. Our IoT business also achieved good progress in its expansion in international markets. It will become an increasingly important contributor to our international revenue growth.

6. Strategic update

AIoT

Our IoT platform continues to grow and maintain a leading position in the industry. As of December 31, 2018, the number of connected IoT devices (excluding smartphones and laptops) on our IoT platform reached approximately 150.9 million units, a quarter-on-quarter increase of 14.7% and a year-on-year increase of 193.2%. We are encouraging increasingly more third-parties to join our open IoT platform. In December 2018, we entered into a strategic partnership with IKEA, pursuant to which IKEA's full range of smart lighting products will be connected to Xiaomi IoT platform. Our IoT user base is diversified across smartphone platforms. Our *Mi Home* app had 20.3 million MAU in December 2018 and over 50% of the users are from non-Xiaomi smartphones. Through the empowerment of AI, we greatly enhanced the user experience of our IoT devices. As of December 31, 2018, our AI assistant "小愛同學" had been installed and activated on more than 100 million smart devices and had more than 38.8 million MAU, making it one of the most used AI voice interactive platforms in mainland China. By the end of

CHAIRMAN'S STATEMENT

February 2019, our AI speakers have accumulated shipment of over 9 million units. We will continue to enrich our AIoT platforms by connecting more devices, providing more use cases and refining our AI deep learning engines with the massive amount of privacy compliant data.

Multi-brand Strategy

We adopted a multi-brand strategy for our smartphones during the year ended December 31, 2018. Xiaomi and Redmi have become independent brands since January 2019. The Xiaomi brand will focus on pioneering advanced technologies, establishing itself in the mid- to high-end markets, and building online and offline new retail channels. The Redmi brand will pursue the ultimate price-performance ratio and focus on online channels. In addition, Black Shark, Meitu, and POCO brands will target games users, female users, and tech enthusiasts, respectively. This multi-brand strategy allows us to serve different user groups more effectively, and to further expand our user base.

Efficiency

For the year ended December 31, 2018, we continued to expand our efficient offline channels while enhancing our online channels. As of December 31, 2018, we had 586 *Mi Homes* in mainland China, mainly in first-, second- and third-tier cities. Moreover, to establish our offline new retail presence in lower-tier cities and rural areas of China, we have built a sizable authorized store network during the year ended December 31, 2018. As of December 31, 2018, we had 1,378 authorized stores in total, comparing to 62 as of December 31, 2017.

Quality

2018 was a watershed year for improvement in our product quality. In recognition of our dedication to quality improvement, we appointed Mr. Yan Kesheng as the Group's Vice President and Chairman of the Quality Committee.

The quality of our products and services received widespread recognition for the year ended December 31, 2018. For example, we won the Top Prize of "China Quality Technical Award" awarded by the China Association for Quality. We received further prestigious awards including the "2018 People's Ingenuity Product Award" and the "2018 China Quality Benchmark Prize".

As the result of our ongoing efforts, the quality of our products has greatly improved. Our mainland China smartphone fault feedback ratio decreased by 43.7% year-on-year for the year ended December 31, 2018. The actual repair costs within the warranty period incurred has been consistently reducing. In order to share the savings from quality improvement with our users, we redefined the quality standards of smartphones by providing an 18-month long warranty for our *Redmi Note 7 series*, 50% higher than the industry standard.

Our Pledge

Our mission is to relentlessly build amazing products with honest prices to let everyone in the world enjoy a better life through innovative technology. In order to achieve this, as approved by our Board in May 2018, we pledged to our existing and potential users that starting from the year ended December 31, 2018, Xiaomi's Hardware Business ("**HB**"), including sales of smartphones, IoT and lifestyle products, will have an overall net profit margin that will not exceed 5.0% per year. If the net margin exceeds 5.0%, we will return the excess above 5.0% to our users. During the year ended December 31, 2018, our hardware business (including smartphones, IoT and lifestyle products) was profitable with a net margin of less than 1.0% fulfilling our pledge. For the definition of hardware business net margin, please refer to Hardware Business Net Margin.

Strategic Cooperation

1. We entered into a strategic cooperation agreement with Meitu, Inc. ("**Meitu**") in the fourth quarter of 2018, pursuant to which we would be responsible for the design, research and development, production, business operation, sales and marketing of Meitu branded smartphones (the "**Cooperation Smartphones**") while Meitu would be responsible for certain image-related algorithms and technologies of the Cooperation Smartphones cameras. Meitu's image-related algorithms and technologies can help us provide better photographic experience to our users. At the same time, the strength of Meitu's brand among females can also help us continue to expand and diversify our user base.

2. We entered into a strategic partnership with TCL Corporation ("**TCL**") in the fourth quarter of 2018 to start joint research and development in smart hardware and core electronics components. Such cooperation in relation to supply chain and manufacturing capacity in the home appliance industry will help us further expand our business in this industry.

Outlook and Strategy

1. Smartphones and AIoT: In 2019, we officially launched the "smartphones + AIoT" dual-engine strategy. For our smartphones business, we will continue to: (i) strengthen our internal processes; (ii) invest in innovation, quality control and supply chain management; and (iii) promote our multi-brand strategy. We will also continue to invest in the development of our open AIoT platform. With the upcoming 5G deployment, we believe that there will be more innovative applications available for AIoT in the future. We expect to invest over RMB10.0 billion in the development in AIoT in the next 5 years to capture this exciting opportunity.

2. International: We will continue to explore the global markets and replicate the success in India in other key markets such as Indonesia and Western Europe. We will also expand into more new international markets in 2019.

CHAIRMAN'S STATEMENT

3. New retail: In mainland China, we will continue to strengthen our distribution capabilities and build an omni-channel new retail network that delivers comprehensive product categories. While maintaining our leading position in the e-commerce market, we will continue to optimize our offline distribution channel to further strengthen our advantage in efficiency. We will also replicate our experience in building new retail channel into international markets.

4. Internet: We will further diversify, enhance and optimize our internet services in mainland China and continue to expand and diversify our client base. Meanwhile, we will actively expand our fast-growing IoT device-based internet services, such as TV internet services and overseas internet services, and continue to grow the services that have the potential to expand to non-Xiaomi smartphone users, such as internet finance and the Youpin e-commerce platform.

Lei Jun
Chairman

Hong Kong
March 19, 2019

MANAGEMENT DISCUSSION AND ANALYSIS

Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

The following table sets forth the comparative figures for the years ended December 31, 2018 and 2017:

	Year ended December 31, 2018	2017
	(RMB in millions)	
Revenue	174,915.4	114,624.7
Cost of sales	(152,723.5)	(99,470.5)
Gross profit	22,191.9	15,154.2
Selling and marketing expenses	(7,993.1)	(5,231.5)
Administrative expenses	(12,099.1)	(1,216.1)
Research and development expenses	(5,776.8)	(3,151.4)
Fair value changes on investments measured at fair value through profit or loss	4,430.4	6,371.1
Share of losses of investments accounted for using the equity method	(614.9)	(231.5)
Other income	844.8	448.7
Other gains, net	213.3	72.0
Operating profit	1,196.5	12,215.5
Finance income, net	216.3	26.7
Fair value changes of convertible redeemable preferred shares	12,514.3	(54,071.6)
Profit/(loss) before income tax	13,927.1	(41,829.4)
Income tax expenses	(449.4)	(2,059.7)
Profit/(loss) for the year	13,477.7	(43,889.1)
Non-IFRS Measure: Adjusted net profit	8,554.5	5,361.9

MANAGEMENT DISCUSSION AND ANALYSIS

Revenue

Revenue increased by 52.6% to RMB174.9 billion for the year ended December 31, 2018, compared to RMB114.6 billion for the year ended December 31, 2017. The following table sets forth our revenue by line of business for the year ended December 31, 2018 and the year ended December 31, 2017.

	Year ended December 31,			
	2018		2017	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	**113,800.4**	**65.1%**	80,563.6	70.3%
IoT and lifestyle products	**43,816.9**	**25.1%**	23,447.8	20.5%
Internet services	**15,955.6**	**9.1%**	9,896.4	8.6%
Others	**1,342.5**	**0.7%**	716.9	0.6%
Total revenue	**174,915.4**	**100.0%**	114,624.7	100.0%

Smartphones

Revenue from our smartphones segment increased by 41.3% from RMB80.6 billion for the year ended December 31, 2017 to RMB113.8 billion for the year ended December 31, 2018, driven by growth in both sales volume and ASP. We sold approximately 118.7 million smartphone units for the year ended December 31, 2018, compared to approximately 91.4 million units for the year ended December 31, 2017. The ASP of our smartphones was RMB959.1 per unit for the year ended December 31, 2018, compared with RMB881.3 per unit for the year ended December 31, 2017. The increase in ASP was primarily due to strong sales of our mid- to high-end models in the mainland China market, consistent with the shifts in consumer demand in mainland China's smartphone market and our strategy to optimize our product portfolio. In overseas markets, as we are shipping increasingly more smartphones to developed markets, the ASP of our smartphones in overseas markets also recorded a 9.7% growth year-on-year.

IoT and lifestyle products

Revenue from our IoT and lifestyle products segment increased by 86.9% from RMB23.4 billion for the year ended December 31, 2017 to RMB43.8 billion for the year ended December 31, 2018, primarily due to the rapid growth in demand of our smart TVs and several sought-after ecosystem products such as *Mi Band*, *Mi Electric Scooter* and *Mi Robot Vacuum Cleaner*. Revenue from smart TVs and laptops, increased by 118.4% from RMB8.3 billion for the year ended December 31, 2017 to RMB18.2 billion for the year ended December 31, 2018.

Internet services

Revenue from our internet services segment increased by 61.2% from RMB9.9 billion for the year ended December 31, 2017 to RMB16.0 billion for the year ended December 31, 2018, primarily due to growth in advertising and other internet value-added services. Our MIUI MAU increased by 41.7% from 170.8 million in December 2017 to 242.1 million in December 2018.

Others

Other revenue increased by 87.3% from RMB716.9 million for the year ended December 31, 2017 to RMB1,342.5 million for the year ended December 31, 2018, primarily due to an increase in out-of-warranty service revenue in-line with our increase in hardware sales.

Cost of Sales

Our cost of sales increased by 53.5% from RMB99.5 billion for the year ended December 31, 2017 to RMB152.7 billion for the year ended December 31, 2018.

	Year ended December 31,			
	2018		2017	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	106,757.1	61.0%	73,462.3	64.1%
IoT and lifestyle products	39,306.1	22.5%	21,497.0	18.8%
Internet services	5,683.9	3.2%	3,935.6	3.4%
Others	976.4	0.6%	575.6	0.5%
Total cost of sales	152,723.5	87.3%	99,470.5	86.8%

MANAGEMENT DISCUSSION AND ANALYSIS

Smartphones

Cost of sales related to our smartphones segment increased by 45.3% from RMB73.5 billion for the year ended December 31, 2017 to RMB106.8 billion for the year ended December 31, 2018, mainly due to increased sales of our smartphones and the appreciation of the United States dollar against the RMB and Indian Rupee.

We reassessed warranty provision in the fourth quarter of 2018. Through our relentless efforts over the past years, in particular, the work conducted by the newly established group level Quality Committee, the quality of our products has greatly improved. The actual repair costs within the warranty period incurred has been consistently reducing and was lower than the warranty provisioned during the year ended December 31, 2018. Therefore, we revisited the warranty provision percentage to better reflect the actual business performance while ensuring that the warranty provision to cover future claims on products under warranty is adequate. This has taken into account the new 18-month long warranty program for some smartphone models. The warranty provision remained stable at RMB1.7 billion as of December 31, 2018, compared to RMB1.7 billion as of December 31, 2017. The warranty expenses recognized in the year ended December 31, 2018 was RMB1.1 billion, compared to RMB1.8 billion in the year ended December 31, 2017. In order to return some of the gains from quality improvement to our users, we reflected these factors in the pricing of smartphones and provided discounts to our users on certain existing smartphone models. Such promotions resulted in additional inventory provision for unsold smartphones.

Furthermore, in anticipation of the separation of Redmi brand and new Xiaomi smartphone product launches in the first quarter of 2019, we increased the provision for impairment of inventories. The provision for impairment on our balance sheet was RMB1.9 billion as of December 31, 2018, compared to RMB0.7 billion as of December 31, 2017. Such additional provision provides us with pricing flexibility to promote existing smartphone models after the launch of new smartphones in 2019.

IoT and lifestyle products

Cost of sales in our IoT and lifestyle products segment increased by 82.8% from RMB21.5 billion for the year ended December 31, 2017 to RMB39.3 billion for the year ended December 31, 2018, primarily due to increased sales of smart TVs and other IoT products.

Internet services

Cost of sales related to our internet services segment increased by 44.4% from RMB3.9 billion for the year ended December 31, 2017 to RMB5.7 billion for the year ended December 31, 2018, primarily due to increased infrastructure service spending resulting from higher user traffic and engagement.

Others

Cost of sales in our others segment increased by 69.6% from RMB575.6 million for the year ended December 31, 2017 to RMB976.4 million for the year ended December 31, 2018, primarily due to increased out-of-warranty service costs.

Gross Profit and Margin

Because of the above mentioned, our gross profit increased by 46.4% from RMB15.2 billion for the year ended December 31, 2017 to RMB22.2 billion for the year ended December 31, 2018. The gross profit margin from our smartphones segment decreased from 8.8% for the year ended December 31, 2017 to 6.2% for the year ended December 31, 2018. In order to lay the groundwork to capture long term value, we selectively prioritized higher growth to capture market share in key products over higher gross margins. We are also closely monitoring changes in currency exchange rates and will take necessary measures to mitigate exchange rate impact.

The gross profit margin from our IoT and lifestyle products segment increased from 8.3% for the year ended December 31, 2017 to 10.3% for the year ended December 31, 2018, mainly due to the improvement of gross margin in our smart TVs. The gross profit margin from our internet services segment increased from 60.2% for the year ended December 31, 2017 to 64.4% for the year ended December 31, 2018, as the percentage of revenue from higher margin advertising business was larger. As a result of the foregoing, our gross margin decreased from 13.2% for the year ended December 31, 2017 to 12.7% for the year ended December 31, 2018.

Selling and Marketing Expenses

Our selling and marketing expenses increased by 52.8% from RMB5.2 billion for the year ended December 31, 2017 to RMB8.0 billion for the year ended December 31, 2018, primarily due to higher packaging and transportation expenses, the compensations for our sales and marketing personnel, and increase of advertising expenses. Packaging and transportation expenses increased by 97.9% from RMB1.0 billion for the year ended December 31, 2017 to RMB1.9 billion for the year ended December 31, 2018, primarily due to rapid growth in our international IoT business. Advertising expenses increased primarily due to our enhanced marketing efforts, such as advertising in relation to the World Cup and several high profile TV shows during the year ended December 31, 2018.

MANAGEMENT DISCUSSION AND ANALYSIS

Administrative Expenses

Our administrative expenses increased from RMB1.2 billion for the year ended December 31, 2017 to RMB12.1 billion for the year ended December 31, 2018, primarily due to an one-off share based compensation. Excluding the one-off share-based compensation relating to administrative expenses, our administrative expenses increased from RMB1.2 billion for the year ended December 31, 2017 to RMB2.2 billion for the year ended December 31, 2018, primarily due to the expansion of our administration departments. Compensation relating to our administrative personnel increased from RMB0.6 billion for the year ended December 31, 2017 to RMB1.3 billion for the year ended December 31, 2018, primarily due to the increased headcount to accommodate for the rapid growth of our business.

Research and Development Expenses

Our research and development expenses increased by 83.3% from RMB3.2 billion for the year ended December 31, 2017 to RMB5.8 billion for the year ended December 31, 2018, primarily due to the increase in total compensation relating to our research and development personnel and the expansion of our smartphones, AI, internet services and other research projects, reflecting our increased focus on research and development. Salaries and benefits relating to research and development personnel increased primarily due to increased headcount to accommodate the rapid growth of our business.

Fair Value Changes on Investments Measured at Fair Value Through Profit or Loss

Our fair value changes on investments measured at fair value through profit or loss decreased by 30.5% from a gain of RMB6.4 billion for the year ended December 31, 2017 to a gain of RMB4.4 billion for the year ended December 31, 2018, primarily due to changes in fair value of our equity and preferred share investments for the year ended December 31, 2018.

Share of Losses of Investments Accounted for Using the Equity Method

Our share of losses of investments accounted for using the equity method increased by 165.6% from RMB231.5 million for the year ended December 31, 2017 to RMB614.9 million for the year ended December 31, 2018, primarily due to share of loss of iQIYI, Inc of RMB616.3 million (NASDAQ ticker: IQ) for the year ended December 31, 2018.

Other Income

Our other income increased by 88.3% from RMB448.7 million for the year ended December 31, 2017 to RMB844.8 million for the year ended December 31, 2018, primarily due to increase of income from wealth management products.

Other Gains, Net

Our net other gains, increased by 196.1% from RMB72.0 million in the year ended December 31, 2017 to RMB213.3 million in the year ended December 31, 2018, primarily due to the recognition of foreign exchange losses of RMB14.6 million for the year ended December 31, 2018, compared to foreign exchange losses of RMB144.3 million for the year ended December 31, 2017. The decrease in foreign exchange losses primarily resulted from the increase in United States Dollar assets from the gross proceeds of our initial public offering.

Finance Income, Net

Our net finance income increased by 707.8% from RMB26.7 million in the year of 2017 to RMB216.3 million in the year of 2018, primarily due to increase in our interest income. Our interest income increased primarily due to more bank deposits which generated higher interest received.

Fair Value Changes of Convertible Redeemable Preferred Shares

Changes in the fair value of our convertible redeemable preferred shares were recorded as "fair value changes of convertible redeemable preferred shares". Fair value changes of convertible redeemable preferred shares changed from a loss of RMB54.1 billion for the year ended December 31, 2017 to a gain of RMB12.5 billion for the year ended December 31, 2018, primarily due to revaluation of equity value of the Company based on the Offer Price in the Global Offering. After the completion of the Global Offering, all our convertible redeemable preferred shares were automatically converted to our Class B ordinary shares (the "**Class B Shares**"). The fair value of each of convertible redeemable preferred share is equivalent to the fair value of each of our Class B Shares on the conversion date, which is the Offer Price in the Global Offering.

Income Tax Expenses

Our income tax expenses decreased from RMB2.1 billion for the year ended December 31, 2017 to RMB0.4 billion for the year ended December 31, 2018, primarily due to: 1) an increase of deferred tax assets, and 2) a subsidiary becoming qualified as a "Key Software Enterprise" which enjoys a preferential income tax rate of 10%. This resulted in a reversal of over accrued income tax expense during the year ended December 31, 2018.

Profit/(Loss) for the Year

As a result of the above mentioned, we reached a profit of RMB13.5 billion for the year ended December 31, 2018, compared with a loss of RMB43.9 billion for the year ended December 31, 2017.

MANAGEMENT DISCUSSION AND ANALYSIS

Fourth Quarter of 2018 Compared to Fourth Quarter of 2017

The following table sets forth the comparative figures for the fourth quarter of 2018 and the fourth quarter of 2017:

	Unaudited Three months ended	
	December 31, 2018	December 31, 2017
	(RMB in millions)	
Revenue	44,421.4	35,114.1
Cost of sales	(38,760.2)	(31,473.6)
Gross profit	5,661.2	3,640.5
Selling and marketing expenses	(2,327.8)	(1,914.5)
Administrative expenses	(593.6)	(450.1)
Research and development expenses	(1,775.0)	(1,034.6)
Fair value changes on investments measured at fair value through profit or loss	2,075.3	2,780.6
Share of losses of investments accounted for using the equity method	(318.3)	(13.7)
Other income	220.2	145.5
Other gains/(losses), net	271.3	(139.7)
Operating profit	3,213.3	3,014.0
Finance income, net	130.8	16.2
Fair value changes of convertible redeemable preferred shares	—	(15,733.3)
Profit/(loss) before income tax	3,344.1	(12,703.1)
Income tax income/(expenses)	47.9	(359.7)
Profit/(loss) for the period	3,392.0	(13,062.8)
Non-IFRS Measure: Adjusted net profit	1,853.2	550.4

Revenue

Revenue increased by 26.5% to RMB44.4 billion for the fourth quarter of 2018 on a year-on-year basis. The following table sets forth our revenue by line of business for the fourth quarter of 2018 and the fourth quarter of 2017:

	Unaudited Three months ended			
	December 31, 2018		December 31, 2017	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	25,077.3	56.5%	23,440.1	66.8%
IoT and lifestyle products	14,936.7	33.6%	8,513.9	24.2%
Internet services	4,037.3	9.1%	2,897.6	8.3%
Others	370.1	0.8%	262.5	0.7%
Total revenue	44,421.4	100.0%	35,114.1	100.0%

Smartphones

Revenue from our smartphones segment increased by 7.0% from RMB23.4 billion for the fourth quarter of 2017 to RMB25.1 billion for the fourth quarter of 2018, driven by growth in the ASP of our smartphones. We sold approximately 25.0 million units of smartphones in the fourth quarter of 2018, compared to approximately 28.5 million units in the fourth quarter of 2017. The decline in shipment is mainly due to our smartphone launch schedule during the year ended December 31, 2018 reflecting our product strategy. We only launched two new smartphone models which are *Mi MIX 3* in October 2018 and *Mi Play* in late December 2018. Furthermore, *Mi MIX 3* is the most premium phone in our 2018 portfolio. This product enhanced our presence in the high-end smartphone market. The fourth quarter of 2018 was a period of adjustment to prepare for the launch of Redmi brand and our new Xiaomi smartphone products in 2019. We launched *Redmi Note 7* series in January 2019 and its shipment exceeded one million units in mainland China alone within a month. We expect the shipment of *Redmi Note 7* series to exceed 4 million units by the end of March 2019. *Mi 9* series were launched in February 2019, and we expect its supply to exceed 1.5 million units by the end of March 2019.

The ASP of our smartphones was RMB1,004.7 per unit for the fourth quarter of 2018, compared with RMB823.9 per unit for the fourth quarter of 2017. The increase in ASP was primarily due to strong sales performance of our mid- to high-end models and increasing proportion of international smartphone shipments to Western Europe.

MANAGEMENT DISCUSSION AND ANALYSIS

IoT and lifestyle products

Our revenue from our IoT and lifestyle products segment increased by 75.4% from RMB8.5 billion for the fourth quarter of 2017 to RMB14.9 billion for the fourth quarter of 2018, primarily due to the rapid growth in demand of our smart TVs and several sought-after ecosystem products such as *Mi Band*, *Mi Electric Scooter* and *Mi Robot Vacuum Clean*er. Revenue from smart TVs and laptops, increased by 97.5% from RMB3.3 billion for the fourth quarter of 2017 to RMB6.6 billion for the fourth quarter of 2018.

Internet services

Revenue from our internet services segment increased by 39.3% from RMB2.9 billion for the fourth quarter of 2017 to RMB4.0 billion for the fourth quarter of 2018, primarily due to growth in advertising business. Our MIUI MAU increased by 41.7% from 170.8 million in December 2017 to 242.1 million in December 2018.

Others

Our other revenue increased by 41.0% from RMB262.5 million for the fourth quarter of 2017 to RMB370.1 million for the fourth quarter of 2018, primarily due to the increased out-of-warranty service revenue.

Cost of Sales

Our cost of sales increased by 23.2% from RMB31.5 billion for the fourth quarter of 2017 to RMB38.8 billion for the fourth quarter of 2018.

	Unaudited Three months ended			
	December 31, 2018		December 31, 2017	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	**23,557.5**	**53.0%**	21,740.7	61.9%
IoT and lifestyle products	**13,358.9**	**30.1%**	8,207.1	23.4%
Internet services	**1,496.5**	**3.4%**	1,233.0	3.5%
Others	**347.3**	**0.8%**	292.8	0.8%
Total cost of sales	**38,760.2**	**87.3%**	31,473.6	89.6%

Smartphones

Cost of sales related to our smartphones segment increased by 8.4% from RMB21.7 billion for the fourth quarter of 2017 to RMB23.6 billion for the fourth quarter of 2018, due to strong sales performance of our mid- to high-end models in the mainland China market with higher ASPs.

We reassessed warranty provision in the fourth quarter of 2018. Through our relentless efforts over the past years, in particular, the work conducted by the newly established group level Quality Committee, the quality of our products has greatly improved. The actual repair costs within the warranty period incurred has been consistently reducing and was lower than the warranty provisioned during the year ended December 31, 2018. Therefore, we revisited the warranty provision percentage to better reflect the actual business performance while ensuring that the warranty provision to cover future claims on products under warranty is adequate. This has taken into account the new 18-month long warranty program for some smartphone models. In order to return some of the gains from quality improvement to our users, we reflected these factors in the pricing of smartphones and provided discounts to our users on certain existing smartphone models. Such promotions resulted in additional inventory provision for unsold smartphones.

Furthermore, in anticipation of the separation of Redmi brand and new Xiaomi smartphone product launches in the first quarter of 2019, we increased the provision for impairment of inventories. Such additional provision provides us with pricing flexibility to promote existing smartphone models after the launch of new smartphones in 2019.

IoT and lifestyle products

Cost of sales in our IoT and lifestyle products segment increased by 62.8% from RMB8.2 billion for the fourth quarter of 2017 to RMB13.4 billion for the fourth quarter of 2018, primarily due to increased sales of smart TVs and laptops and other IoT products.

Internet services

Cost of sales related to our internet services segment increased by 21.4% from RMB1.2 billion for the fourth quarter of 2017 to RMB1.5 billion for the fourth quarter of 2018, primarily due to growth in costs from financial services and increased infrastructure service spending resulting from higher user traffic and engagement.

Others

Cost of sales in our others segment increased by 18.6% from RMB292.8 million for the fourth quarter of 2017 to RMB347.3 million for the fourth quarter of 2018, primarily due to the increased out-of-warranty service costs.

MANAGEMENT DISCUSSION AND ANALYSIS

Gross Profit and Margin

Because of the above mentioned, our gross profit increased by 55.5% from RMB3.6 billion for the fourth quarter of 2017 to RMB5.7 billion for the fourth quarter of 2018.

The gross profit margin from our smartphones segment decreased from 7.3% for the fourth quarter of 2017 to 6.1% for the fourth quarter of 2018. In order to lay the groundwork to capture long term value, we selectively prioritized higher growth to capture market share in key products over higher gross margins. We are also closely monitoring changes in currency exchange rates and will take necessary measures to mitigate exchange rate impact. We also reassessed warranty provision percentage and incurred more inventory provision in the fourth quarter of 2018.

The gross profit margin from our IoT and lifestyle products segment increased from 3.6% for the fourth quarter of 2017 to 10.6% for the fourth quarter of 2018. The gross profit margin from our internet services segment increased from 57.4% for the fourth quarter of 2017 to 62.9% for the fourth quarter of 2018. As a result of the foregoing, our gross margin increased from 10.4% for the fourth quarter of 2017 to 12.7% for the fourth quarter of 2018.

Selling and Marketing Expenses

Our sale and marketing expenses increased by 21.6% from RMB1.9 billion for the fourth quarter of 2017 to RMB2.3 billion for the fourth quarter of 2018, primarily due to the increase in higher packaging and transportation expenses, offset by the decrease of advertising expenses. The packaging and transportation increased from RMB319.9 million for the fourth quarter of 2017 to RMB693.5 million for the fourth quarter of 2018. Advertising expenses decreased primarily due to reduced marketing expenses in relation to the TV shows.

Administrative Expenses

Our administrative expenses increased by 31.9% from RMB450.1 million for the fourth quarter of 2017 to RMB593.6 million for the fourth quarter of 2018, primarily due to the expansion of our administration departments. Compensation relating to our administrative personnel increased from RMB157.5 million for the fourth quarter of 2017 to RMB325.5 million for the fourth quarter of 2018, primarily due to the increased headcount to accommodate for the rapid growth of our business.

Research and Development Expenses

Our research and development expenses increased by 71.6% from RMB1.0 billion for the fourth quarter of 2017 to RMB1.8 billion for the fourth quarter of 2018, primarily due to the expansion of our research and development efforts for our smartphones, AI, internet services efforts and expansion of our research projects, reflecting our increased focus on research and development. The compensation relating to our research and development personnel increased primarily due to the increased headcount to accommodate for the rapid growth of our business.

Fair Value Changes on Investments Measured at Fair Value Through Profit or Loss

Our fair value changes on investments measured at fair value through profit or loss decreased by 25.4% from a gain of RMB2.8 billion of the fourth quarter of 2017 to a gain of RMB2.1 billion for the fourth quarter of 2018, primarily due to changes in fair value of our equity and preferred share investments for the fourth quarter of 2018.

Share of Losses of Investments Accounted for Using the Equity Method

Our share of losses of investments accounted for using the equity method increased from RMB13.7 million in the fourth quarter of 2017 to RMB318.3 million in the fourth quarter of 2018, primarily due to share of loss of iQIYI, Inc. (NASDAQ ticker: IQ) in the fourth quarter of 2018.

Other Income

Our other income increased by 51.3% from RMB145.5 million for the fourth quarter of 2017 to RMB220.2 million for the fourth quarter of 2018, primarily due to increase in value-added tax refunds and increase of income from wealth management products.

Other Gains/(Losses), Net

Our other gains/(losses), net changed from RMB139.7 million net losses for the fourth quarter of 2017 to RMB271.3 million net gains for the fourth quarter of 2018, primarily due to the recognition of foreign exchange gains of RMB135.9 million for the fourth quarter of 2018, compared to foreign exchange losses of RMB19.4 million for the fourth quarter of 2017. The net changes from foreign exchange losses to foreign exchange gains primarily resulted from the increase in United States Dollar assets from the gross proceeds of our initial public offering.

Finance Income, Net

Our net finance income increased by 707.7% from RMB16.2 million in the fourth quarter of 2017 to RMB130.8 million in the fourth quarter of 2018, primarily due to increase in our interest income. Our interest income increased primarily due to more bank deposits which generated higher interest received.

Fair Value Changes of Convertible Redeemable Preferred Shares

Changes in the fair value of our convertible redeemable preferred shares were recorded as "fair value changes of convertible redeemable preferred shares". We did not incur fair value changes of convertible redeemable preferred shares for the fourth quarter of 2018, compared to a loss of RMB15.7 billion for the fourth quarter of 2017. After the completion of the Global Offering, all our convertible redeemable preferred shares were automatically converted to our Class B Shares and thus in the fourth quarter of 2018 and forward, we will not incur fair value changes of convertible redeemable preferred shares.

MANAGEMENT DISCUSSION AND ANALYSIS

Income Tax Income/(Expenses)

Our income tax income/(expenses) changed from RMB359.7 million income tax expenses in the fourth quarter of 2017 to an income tax income of RMB47.9 million in the fourth quarter of 2018, primarily due to: 1) an increase of deferred tax assets, and 2) a subsidiary becoming qualified as a "Key Software Enterprise" which enjoys a preferential income tax rate of 10%. This resulted in a reversal of over accrued income tax expense during the fourth quarter of 2018.

Profit/(Loss) for the Period

As a result of the foregoing, we had a loss of RMB13.1 billion and a profit of RMB3.4 billion for the fourth quarter of 2017 and 2018, respectively.

Fourth Quarter of 2018 Compared to Third Quarter of 2018

The following table sets forth the comparative figures for the fourth quarter of 2018 and the third quarter of 2018:

	Unaudited Three months ended	
	December 31, 2018	September 30, 2018
	(RMB in millions)	
Revenue	44,421.4	50,846.2
Cost of sales	(38,760.2)	(44,268.7)
Gross profit	5,661.2	6,577.5
Selling and marketing expenses	(2,327.8)	(2,186.9)
Administrative expenses	(593.6)	(583.3)
Research and development expenses	(1,775.0)	(1,534.4)
Fair value changes on investments measured at fair value through profit or loss	2,075.3	65.3
Share of losses of investments accounted for using the equity method	(318.3)	(184.4)
Other income	220.2	259.1
Other gains/(losses), net	271.3	(202.3)
Operating profit	3,213.3	2,210.6
Finance income, net	130.8	100.1
Fair value changes of convertible redeemable preferred shares	—	52.9
Profit before income tax	3,344.1	2,363.6
Income tax income	47.9	116.9
Profit for the period	3,392.0	2,480.5
Non-IFRS Measure: Adjusted net profit	1,853.2	2,885.2

Revenue

Revenue decreased by 12.6% to RMB44.4 billion for the fourth quarter of 2018 on a quarter-on-quarter basis. The following table sets forth our revenue by line of business for the fourth quarter of 2018 and the third quarter of 2018:

	Unaudited Three months ended			
	December 31, 2018		September 30, 2018	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	25,077.3	56.5%	34,982.5	68.8%
IoT and lifestyle products	14,936.7	33.6%	10,804.8	21.3%
Internet services	4,037.3	9.1%	4,728.7	9.3%
Others	370.1	0.8%	330.2	0.6%
Total revenue	44,421.4	100.0%	50,846.2	100%

Smartphones

Revenue from our smartphones segment decreased by 28.3% from RMB35.0 billion for the third quarter of 2018 to RMB25.1 billion for the fourth quarter of 2018, due to adjustments in product mix and our product launch schedule. We sold approximately 25.0 million units of smartphones for the fourth quarter of 2018, compared to approximately 33.3 million units in the third quarter of 2018. The decline in shipment is mainly due to our smartphone launch schedule during the year ended December 31, 2018 reflecting our product strategy. We only launched two new smartphone models which are *Mi MIX 3* in October 2018 and *Mi Play* in late December 2018. Furthermore, *Mi MIX 3* is the most premium phone in our 2018 portfolio. This product enhanced our presence in the high-end smartphone market. The fourth quarter of 2018 was a period of adjustment to prepare for the launch of Redmi brand and our new Xiaomi smartphone products in 2019. We launched *Redmi Note 7* series in January 2019 and its shipment exceeded one million units in mainland China alone within a month. We expect the shipment of *Redmi Note 7* series to exceed 4 million units by the end of March 2019. *Mi 9* series were launched in February 2019, and we expect its supply to exceed 1.5 million units by the end of March 2019.

The ASP of our smartphones was RMB1,004.7 per unit for the fourth quarter of 2018, compared with RMB1,052.0 per unit for the third quarter of 2018, primarily due to enhanced marketing efforts during various online shopping festivals in the fourth quarter of 2018.

MANAGEMENT DISCUSSION AND ANALYSIS

IoT and lifestyle products

Our revenue from our IoT and lifestyle products segment increased by 38.2% from RMB10.8 billion for the third quarter of 2018 to RMB14.9 billion for the fourth quarter of 2018, primarily due to strong growth in existing products, particularly smart TVs and laptops and also the rapid growth in demand of our smart TVs, laptops and several sought-after ecosystem products such as *Mi Air Purifier*, *Mi Robot Vacuum Cleaner*, and *Mi Power Bank*. Revenue from smart TVs and laptops, increased by 55.1% from RMB4.2 billion for the third quarter of 2018 to RMB6.6 billion for the fourth quarter of 2018.

Internet services

Revenue from our internet services segment decreased by 14.6% from RMB4.7 billion for the third quarter of 2018 to RMB4.0 billion for the fourth quarter of 2018, primarily due to decreased advertising revenue. In the fourth quarter of 2018, over 30% of our internet services revenue was from internet services outside of advertising and gaming from China smartphones. We believe this reflects increasing diversification of our internet services revenue. Our MIUI MAU increased by 7.9% from 224.4 million in September 2018 to 242.1 million in December 2018.

Cost of Sales

Our cost of sales decreased by 12.4% from RMB44.3 billion for the third quarter of 2018 to RMB38.8 billion for the fourth quarter of 2018.

	Unaudited			
	Three months ended			
	December 31, 2018		September 30, 2018	
	Amount	% of total revenue	Amount	% of total revenue
	(RMB in millions, unless specified)			
Smartphones	**23,557.5**	**53.0%**	32,847.4	64.6%
IoT and lifestyle products	**13,358.9**	**30.1%**	9,672.8	19.0%
Internet services	**1,496.5**	**3.4%**	1,494.9	2.9%
Others	**347.3**	**0.8%**	253.6	0.6%
Total cost of sales	**38,760.2**	**87.3%**	44,268.7	87.1%

Smartphones

Cost of sales related to our smartphones segment decreased by 28.3% from RMB32.8 billion for the third quarter of 2018 to RMB23.6 billion for the fourth quarter of 2018, primarily due to decline in sales of our smartphones.

We reassessed warranty provision in the fourth quarter of 2018. Through our relentless efforts over the past years, in particular, the work conducted by the newly established group level Quality Committee, the quality of our products has greatly improved. The actual repair costs within the warranty period incurred has been consistently reducing and was lower than the warranty provisioned during the year ended December 31, 2018. Therefore, we revisited the warranty provision percentage to better reflect the actual business performance while ensuring that the warranty provision to cover future claims on products under warranty is adequate. This has taken into account the new 18-month long warranty program for some smartphone models. In order to return some of the gains from quality improvement to our users, we reflected these factors in the pricing of smartphones and provided discounts to our users on certain existing smartphone models. Such promotions resulted in additional inventory provision for unsold smartphones.

Furthermore, in anticipation of the separation of Redmi brand and new Xiaomi smartphone product launches in the first quarter of 2019, we increased the provision for impairment of inventories in the year ended December 31, 2018. Such additional provision provides us with pricing flexibility to promote existing smartphone models after the launch of new smartphones in 2019.

IoT and lifestyle products

Cost of sales in our IoT and lifestyle products segment increased by 38.1% from RMB9.7 billion for the third quarter of 2018 to RMB13.4 billion for the fourth quarter of 2018, primarily due to increased sales of smart TVs and laptops and other IoT products.

Internet services

Cost of sales related to our internet services segment remained stable compared with the third quarter of 2018.

Others

Cost of sales in our others segment increased by 36.9% from RMB253.6 million for the third quarter of 2018 to RMB347.3 million for the fourth quarter of 2018, primarily due to increased out-of-warranty service costs.

MANAGEMENT DISCUSSION AND ANALYSIS

Gross Profit and Margin

As a result of the foregoing, our gross profit decreased by 13.9% from RMB6.6 billion for the third quarter of 2018 to RMB5.7 billion for the fourth quarter of 2018. The gross profit margin from our smartphones segment remained stable. The gross profit margin from our IoT and lifestyle products segment increased from 10.5% for the third quarter of 2018 to 10.6% for the fourth quarter of 2018. The gross profit margin from our internet services segment decreased from 68.4% for the third quarter of 2018 to 62.9% in the fourth quarter of 2018. As a result of this activity, our gross margin decreased from 12.9% for the third quarter of 2018 to 12.7% for the fourth quarter of 2018. We also reassessed warranty provision percentage and incurred more inventory provision in the fourth quarter of 2018.

Selling and Marketing Expenses

Our selling and marketing expenses increased by 6.4% from RMB2.2 billion for the third quarter of 2018 to RMB2.3 billion for the fourth quarter of 2018, primarily due to higher packaging and transportation expenses and the compensation for our selling and marketing personnel, offset by the decrease of advertising for our selling and marketing. Packaging and transportation expenses increased by 43.8% from RMB482.3 million for the third quarter of 2018 to RMB693.5 million for the fourth quarter of 2018, primarily due to the rapid growth of international business. Advertising expenses decreased primarily due to the promotion of Mi8 and the advertisements for World Cup during the third quarter of 2018.

Administrative Expenses

Our administrative expenses increased by 1.8% from RMB583.3 million for the third quarter of 2018 to RMB593.6 million for the fourth quarter of 2018. There is no major fluctuation between the fourth quarter of 2018 and the third quarter of 2018.

Research and Development Expenses

Our research and development expenses increased by 15.7% from RMB1.5 billion for the third quarter of 2018 to RMB1.8 billion for the fourth quarter of 2018, primarily due to the increase in total salaries and bonus relating to our research and development personnel and the expansion of our research and development efforts for our smartphones, AI and internet services businesses.

Fair Value Changes on Investments Measured at Fair Value Through Profit or Loss

Our fair value changes on investments measured at fair value through profit or loss increased from a gain of RMB65.3 million for the third quarter of 2018 to a gain of RMB2,075.3 million for the fourth quarter of 2018, primarily due to changes in fair value of the equity and preferred share investments for the fourth quarter of 2018.

Share of Losses of Investments Accounted for Using the Equity Method

Our share of losses of investments accounted for using the equity method increased by 72.6% from RMB184.4 million in the third quarter of 2018 to RMB318.3 million in the fourth quarter of 2018, primarily due to share of loss of Xunlei Limited (NASDAQ ticker: XNET) and iQIYI, Inc. (NASDAQ ticker: IQ) in the fourth quarter compared to the third quarter of 2018.

Other Income

Our other income decreased by 15.0% from RMB259.1 million in the third quarter of 2018 to RMB220.2 million in the fourth quarter of 2018.

Other Gains/(Losses), Net

Our other gains/(losses), net changed from RMB202.3 million net losses for the third quarter of 2018 to RMB271.3 million net gains for the fourth quarter of 2018, primarily due to the recognition of foreign exchange gains of RMB135.9 million for the fourth quarter of 2018, compared to foreign exchange losses of RMB197.0 million for the third quarter of 2018 due to the depreciation of United States Dollar against RMB in the fourth quarter of 2018, compared with the appreciation of Unites States Dollar against RMB in the third quarter of 2018.

Finance Income, Net

Our net finance income increased by 30.8% from RMB100.1 million in the third quarter of 2018 to RMB130.8 million in the fourth quarter of 2018, primarily due to increase in our interest income. Our interest income increased primarily due to more bank deposits which generated higher interest received.

MANAGEMENT DISCUSSION AND ANALYSIS

Fair Value Changes of Convertible Redeemable Preferred Shares

Changes in the fair value of our convertible redeemable preferred shares were recorded as "fair value changes of convertible redeemable preferred shares". We did not incur fair value changes of convertible redeemable preferred shares for the fourth quarter of 2018, compared to a gain of RMB52.9 million for the third quarter of 2018. After the completion of the Global Offering, all our convertible redeemable preferred shares were automatically converted to our Class B Shares and thus in the fourth quarter of 2018 and going forward, we will not incur fair value changes of convertible redeemable preferred shares.

Income Tax Income

Our income tax income decreased by 59.0% from RMB116.9 million for the third quarter of 2018 to RMB47.9 million for the fourth quarter of 2018.

Profit for the Period

As a result of the foregoing, we secured a profit of RMB2.5 billion and a profit of RMB3.4 billion for the third and fourth quarter of 2018, respectively.

Non-IFRS Measure: Adjusted Net Profit

To supplement our consolidated results which are prepared and presented in accordance with International Financial Reporting Standards (the "**IFRS**"), we also use adjusted net profit as an additional financial measure, which is not required by, or presented in accordance with, IFRS. We believe that the presentation of non-IFRS measures when shown in conjunction with the corresponding IFRS measures provides useful information to investors and management regarding financial and business trends in relation to our financial condition and results of operations, by eliminating any potential impact of items that our management does not consider to be indicative of our operating performance such as certain non-cash items and the impact of certain investment transactions. We also believe that the non-IFRS measures are appropriate for evaluating the Group's operating performance. The use of this non-IFRS measure has limitations as an analytical tool, and you should not consider it in isolation from, or as a substitute for analysis of, our results of operations or financial conditions as reported under IFRS. In addition, this non-IFRS financial measure may be defined differently from similar terms used by other companies.

The following tables set forth reconciliations of the Group's Non-IFRS measures for the fourth quarter of 2018 and 2017, the third quarter of 2018, and the years ended December 31, 2018 and 2017 to the nearest measures prepared in accordance with IFRS:

	Unaudited Three Months Ended December 31, 2018						
		Adjustments					
	As reported	Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments[1]	Amortization of intangible assets resulting from acquisitions[2]	Changes of value of financial liabilities to fund investors[3]	Non-IFRS
	(RMB in thousand, unless specified)						
Profit for the period	3,392,027	—	663,297	(2,246,032)	1,408	42,504	1,853,204
Net margin	7.6%						4.2%

	Unaudited Three Months Ended September 30, 2018						
		Adjustments					
	As reported	Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments[1]	Amortization of intangible assets resulting from acquisitions[2]	Changes of value of financial liabilities to fund investors[3]	Non-IFRS
	(RMB in thousand, unless specified)						
Profit for the period	2,480,484	(52,934)	701,813	(246,437)	2,294	—	2,885,220
Net margin	4.9%						5.7%

	Unaudited Three Months Ended December 31, 2017						
		Adjustments					
	As reported	Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments[1]	Amortization of intangible assets resulting from acquisitions[2]	Changes of value of financial liabilities to fund investors[3]	Non-IFRS
	(RMB in thousand, unless specified)						
(Loss)/profit for the period	(13,062,856)	15,733,293	338,860	(2,459,428)	551	—	550,420
Net margin	-37.2%						1.6%

MANAGEMENT DISCUSSION AND ANALYSIS

	Year Ended December 31, 2018						
		Adjustments					
	As reported	Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments[1]	Amortization of intangible assets resulting from acquisitions[2]	Changes of value of financial liabilities to fund investors[3]	Non-IFRS
	(RMB in thousand, unless specified)						
Profit for the year	13,477,747	(12,514,279)	12,380,668	(4,836,835)	4,743	42,504	8,554,548
Net margin	7.7%						4.9%

	Year Ended December 31, 2017						
		Adjustments					
	As reported	Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments[1]	Amortization of intangible assets resulting from acquisitions[2]	Changes of value of financial liabilities to fund investors[3]	Non-IFRS
	(RMB in thousand, unless specified)						
(Loss)/profit for the year	(43,889,115)	54,071,603	909,155	(5,732,151)	2,384	—	5,361,876
Net margin	-38.3%						4.7%

Notes:

(1) Includes fair value gains on equity investments and preferred shares investments deducting the cumulative fair value changes for investments (including the financial assets measured at fair value through profit or loss (**"FAFVPL"**) and the investments using the equity method transferred from FAFVPL) disposed in the current period, the impairment provision for investments, remeasurement of loss of significant influence in an associate, remeasurement of investments transferring from financial asset measured at fair value through profit or loss to investments using the equity method, net of tax.

(2) Represents amortization of intangible assets resulting from acquisitions, net of tax.

(3) Represents the change of value of the financial liabilities payable to the fund investors, net of tax, as a result of the change of fair value of the fund.

Hardware Business Net Margin

HB overall net profit margin rate[1] *= HB overall net profit / Revenue from HB*

HB overall profit before tax *= Revenue from HB – Cost of sales of HB – Selling and marketing expenses of HB – Administrative expenses of HB – Research and development expenses of HB*

HB overall net profit *= HB overall profit before tax – Income tax expenses of HB*

Share-based compensation expenses are excluded from selling and marketing expenses of HB, administrative expenses of HB, research and development expenses of HB. Income tax expenses of HB equals to the HB overall profit before tax multiplied by the effective tax rate of the Group.

Note:

(1) The source data and calculation formulae of HB overall net profit margin rate are provided by the Group. PricewaterhouseCoopers Zhong Tian LLP was engaged by the Group to conduct certain procedures, as mutually agreed by both parties, including agreeing the source data used to the books and records and recalculating the HB overall net profit margin rate based on the formulae provided by the Group.

Liquidity, Financial Resources and Gearing

Other than the funds raised through our Global Offering in July 2018, we have historically funded our cash requirements principally from cash generated from our operations and bank borrowings. We had cash and cash equivalents of RMB30.2 billion and RMB35.2 billion as of December 31, 2018 and September 30, 2018, respectively.

Note:

The cash resources which the Group considered in cash management including but not limited to cash and cash equivalents, restricted cash, short-term bank deposits and short-term investments measured at fair value through profit or loss. As of December 31, 2018, the aggregate amount of cash resources of the Group is RMB39.7 billion.

Our gearing ratio was -73.1% and -45.1%, which represented a net cash position, as of September 30, 2018 and December 31, 2018, respectively. Our gearing ratio is calculated as net debt divided by total capital at the end of each financial period. Net debt equals to our total borrowings less our cash and cash equivalents, restricted cash and short-term bank deposits. Total capital is calculated as total equity plus net debt.

MANAGEMENT DISCUSSION AND ANALYSIS

Consolidated Statement of Cash Flows

	Unaudited Three months ended	
	December 31, 2018	September 30, 2018
	(in thousands of RMB)	
Net cash used in operating activities[1]	**(6,200,817)**	(1,335,297)
Net cash used in investing activities	**(1,454,131)**	(2,228,180)
Net cash generated from financing activities[1]	**2,378,542**	23,002,448
Net (decrease)/increase in cash and cash equivalents	**(5,276,406)**	19,438,971
Cash and cash equivalents at beginning of period	**35,208,793**	14,894,150
Effects of exchange rate changes on cash and cash equivalents	**297,760**	875,672
Cash and cash equivalents at end of period	**30,230,147**	35,208,793

Note:

(1) Excluding (1) the increase in loan and interest receivables and impairment provision for loan receivables mainly resulting from the internet finance business; (2) the increase in trade payables resulting from the finance factoring business; and (3) the increase in restricted cash resulting from the internet finance business, the net cash used in operating activities was RMB4.6 billion for the three months ended December 31, 2018 and the net cash generated from operating activities was RMB1.1 billion for the three months ended September 30, 2018, respectively; excluding the change of borrowings for the internet finance business, the net cash generated from financing activities was RMB1.1 billion for the three months ended December 31, 2018 and RMB23.8 billion for the three months ended September 30, 2018, respectively. The information in this footnote is based on the management accounts of the Group, which have not been audited or reviewed by the Auditor. The accounting policies applied in the preparation of the management accounts are consistent with those used for other figures in this annual report.

Net Cash Used In Operating Activities

Net cash used in operating activities represents cash used in operations, plus income tax paid. Cash used in operations primarily comprise of our profit for the period adjusted by non-cash items and changes in working capital.

For the fourth quarter of 2018, net cash used in operating activities amounted to RMB6.2 billion, representing cash used in operations of RMB5.9 billion plus income tax paid of RMB0.3 billion. Cash used in operations was primarily attributed to our profit before income tax of RMB3.3 billion, offset by a decrease in trade payables of RMB6.3 billion, and an increase in inventories of RMB4.9 billion. The increase in inventories was due to the decline in sales of our smartphones in the fourth quarter of 2018 and our procurement in preparation for the new product launches. Our inventories as of January 31, 2019 declined 12% comparing to that as of December 31, 2018, according to management accounts, primarily attributed to the increase in sales of our smartphones post the launch of new smartphone models. Our inventory turnover days was 55 days in January 2019, excluding the inventories related to real estate business, according to management accounts.

Net Cash Used In Investing Activities

For the fourth quarter of 2018, our net cash used in investing activities was RMB1.5 billion, which was primarily attributed to the net cash used in capital expenditure of RMB2.3 billion, offset by cash generated from the net changes of short-term investments measured at fair value through profit or loss of RMB2.3 billion.

Net Cash Generated From Financing Activities

For the fourth quarter of 2018, our net cash generated from financing activities was RMB2.4 billion, which was primarily attributed to the proceeds from borrowings of RMB3.6 billion, a withdrawal of restricted cash of RMB0.9 billion, partially offset by the repayments of borrowings of RMB2.5 billion.

Borrowings

As of September 30, 2018 and December 31, 2018, we had total borrowings of RMB9.9 billion and RMB10.9 billion, respectively.

Convertible Redeemable Preferred Shares

After the completion of the Global Offering on July 9, 2018, all our convertible redeemable preferred shares were converted into Class B shares. Therefore, no convertible redeemable preferred shares were recognized as of September 30, 2018 and December 31, 2018.

MANAGEMENT DISCUSSION AND ANALYSIS

Capital Expenditure

	Three months ended December 31, 2018	Three months ended September 30, 2018
	(in thousands of RMB)	
Capital expenditures	**2,252,610**	518,971
Placement of long-term investments [1]	**528,060**	561,050
Total	**2,780,670**	1,080,021

Note:

(1) Placement for long-term investments represents equity investments and preferred share investments.

Our capital expenditure primarily included disbursement on property and equipment resulting from the construction of and improvements made to our office complex, as well as on our intangible assets.

Off-Balance Sheet Commitments and Arrangements

As of December 31, 2018, except for financial guarantee contracts, we had not entered into any off-balance sheet arrangements.

Future Plans for Material Investments and Capital Assets

As of December 31, 2018, we did not have other plans for material investments and capital assets.

Material Acquisitions and Disposals of Subsidiaries and Affiliated Companies

For the year ended December 31, 2018, we did not have any material acquisitions or disposals of subsidiaries and affiliated companies.

Employee and Remuneration Policy

As of December 31, 2018, we had 16,683 full-time employees, 15,686 of whom were based in mainland China, primarily at our headquarters in Beijing, with the rest primarily based in India and Indonesia. We expect to continue to increase our headcount in mainland China and our key target global markets. As of December 31, 2018, our research and development personnel, totaling 7,371 employees, were staffed across our various departments.

Our success depends on our ability to attract, retain and motivate qualified personnel. As part of our human resources strategy, we offer employees competitive compensation packages. As of December 31, 2018, 5,966 employees held share-based awards. The total remuneration expenses, including share-based compensation expense, for the year ended December 31, 2018 were RMB17,114.9 million, representing an increase of 322.6% from the year ended December 31, 2017 of RMB4,050.1 million, primarily due to an one-off share-based compensation in the second quarter of 2018.

Foreign Exchange Risk

The transactions of our Company are denominated and settled in our functional currency, the United States dollar. Our Group's subsidiaries primarily operate in the PRC and other regions such as India, and are exposed to foreign exchange risk arising from various currencies exposures, primarily with respect to the United States dollar. Therefore, foreign exchange risk primarily arose from recognized assets and liabilities in our subsidiaries when receiving or to receive foreign currencies from, or paying or to pay foreign currencies to overseas business partners.

We will continue to monitor changes in currency exchange rates and will take necessary measures to mitigate exchange rate impact.

Pledge of Assets

As of December 31, 2018, we pledged a restricted deposit of RMB1,480.2 million, compared with as of September 30, 2018, which was RMB2,321.8 million.

Contingent Liabilities

As of December 31, 2018, we did not have any material contingent liabilities, compared with as of September 30, 2018, which was nil.

DIRECTOR'S REPORT

The Board of the Company is pleased to present this Director's report together with the consolidated financial statements of the Group for the year ended December 31, 2018.

Principal Activities

The Company is an investment holding company. The Group is principally engaged in development and sales of smartphones, IoT and lifestyle products, provision of internet services and investments holding in the PRC and other countries or regions.

Business Review

A fair review of the business of the Group as required by Schedule 5 to the Companies Ordinance (Chapter 622 of the Laws of Hong Kong), including an analysis of the Group's financial performance, an indication of likely future developments in the Group's business, a description of the principal risks and uncertainties facing the Group and the Group's key relationships with its stakeholders who have a significant impact on the Group and on which the Group's success depends, is set out in the sections headed "Chairman's Statement" and "Management Discussion and Analysis" of this annual report. These discussions form part of this annual report. Events affecting the Company that have occurred since the end of the financial year are set out in the section headed "Events after the Report Period" in this annual report.

Share Capital and Shares Issued

Details of movements in the share capital of the Company for the year ended December 31, 2018 and details of the Shares issued during the year ended December 31, 2018 are set out in Note 25 to the consolidated financial statements.

Subsidiaries

Particulars of the Company's subsidiaries are set out in Note 12(a) to the consolidated financial statements.

Property and Equipment

Details of movements in the property and equipment of the Group during the year ended December 31, 2018 are set out in Note 16 to the consolidated financial statements.

Bank Loans and Borrowings

Particulars of bank loans and other borrowings of the Group as of December 31, 2018 are set out in the section headed "Management Discussion and Analysis" in this annual report and Note 33 to the consolidated financial statements.

Donation

During the year ended December 31, 2018, the Group made charitable donations of approximately RMB3.6 million.

Four-Year Financial Summary

A summary of the condensed consolidated results and financial positions of the Group is set out on page 10 of this annual report.

Reserves

As of December 31, 2018, the Company had distributable reserves amounting to RMB39,160.0 million.

Details of the movements in the reserves of the Company during the year ended December 31, 2018 are set out in Note 41 to the consolidated financial statements.

Purchase, Sale or Redemption of the Company's Listed Securities

In January 2019, the Company repurchased a total of 19,972,200 Class B Shares (the "**Shares Repurchased**") of the Company on the Stock Exchange at an aggregate consideration of approximately HK$199,931,233. The Board believed that a share repurchase demonstrated the Company's confidence in its own business outlook and prospects and would, ultimately, benefit the Company and create value to its shareholders. All the Shares Repurchased were subsequently cancelled on February 1, 2019. Particulars of the Shares Repurchased are as follows:

Date of Repurchase	No. of Shares Repurchased	Price paid per share Highest (HK$)	Price paid per share Lowest (HK$)	Aggregate Consideration (HK$)
January 17, 2019	6,140,000	9.79	9.74	59,941,940
January 18, 2019	9,849,600	10.20	10.08	99,999,996
January 22, 2019	3,982,600	10.06	10.00	39,989,297
Total	19,972,200			199,931,233

The number of Class B Shares in issue was reduced by 19,972,200 shares as a result of the cancellation accordingly. Upon cancellation of the Shares Repurchased, the WVR Beneficiaries of the Company, simultaneously reduced their weighted voting rights in the Company proportionately by way of converting their Class A Shares into Class B Shares on a one-to-one ratio pursuant to Rule 8A.21 of the Listing Rules, such that the proportion of shares carrying weighted

DIRECTOR'S REPORT

voting rights of the Company shall not be increased, pursuant to the requirements under Rules 8A.13 and 8A.15 of the Listing Rules. A total of 5,591,700 Class A Shares were converted in Class B Shares on a one-to-one ratio on February 1, 2019, of which Lei Jun, through Smart Mobile Holdings Limited, converted 3,587,263 Class A Shares and Lin Bin, through Bin Lin Trust, converted 2,004,437 Class A Shares.

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's securities listed on the Stock Exchange during the year ended December 31, 2018.

Share Option Schemes

The Company has adopted two share options schemes, namely the Pre-IPO ESOP and the Post-IPO Share Option Scheme. Each of two subsidiaries of the Company, Xiaomi Finance and Pinecone International, has adopted two share options schemes, respectively, which are XMF Share Option Scheme I, XMF Share Option Scheme II, Pinecone Share Option Scheme I and Pinecone Share Option Scheme II.

1. Pre-IPO ESOP

The following is a summary of principal terms of the Pre-IPO ESOP adopted by the Company on May 5, 2011, superseded on August 24, 2012.

(a) Purpose

The purpose of the Pre-IPO ESOP is to promote the success and enhance the value of the Company, by linking the personal interests of the members of the Board, employees, consultants and other individuals to those of the Shareholders and, by providing such individuals with an incentive for outstanding performance, to generate superior returns to the Shareholders. The Pre-IPO ESOP is further intended to provide flexibility to the Company in its ability to motivate, attract and retain the services of recipients upon whose judgment, interest and special effort the successful conduct of the Company's operation is largely dependent.

(b) Eligible participants

The eligible participants include employees, consultants, all members of the Board, and other individuals, as determined, authorized and approved by the Board or a committee authorized by the Board. Awards in the form of share options, restricted share awards and restricted stock units ("**RSU**") may be granted to selected participants.

(c) Maximum number of shares available for issue

The overall limit on the number of Shares which may be issued pursuant to the Pre-IPO ESOP is 251,307,455 Class B Shares, which was subsequently adjusted by the Board to 2,512,694,900 Class B Shares (adjusted after taking into account the share subdivision which took place on June 17, 2018).

(d) **Maximum entitlement of each participant**

There is no maximum entitlement of each participant.

(e) **Option period**

The share options may not be exercised until vested. The Board shall determine the time or times at which an option may be exercised, provided that the term of any option granted under the Pre-IPO ESOP shall not exceed ten years. Once vested, the vested portion of the option may be exercised in whole or in any part, at any time.

As for the RSUs, at the time of grant, the Board shall specify the date or dates on which the RSUs shall become fully vested and nonforfeitable.

(f) **Exercise price and payment**

The exercise price per share subject to a share option under the Pre-IPO ESOP shall be determined by the Board and set out in the award agreement and may be a fixed or variable price related to the fair market value of the Class B Shares.

The Board may set performance objectives or other vesting criteria which, depending on the extent to which they are met, will determine the number or value of RSUs that will be paid out to the selected participants.

(g) **Remaining life of the scheme**

The term of the Pre-IPO ESOP commenced on August 24, 2012 and will expire on the tenth anniversary of the above starting date.

As of December 31, 2018, the Company has conditionally granted share options and/or RSU to eligible participants pursuant to the Pre-IPO ESOP, entitling the holders to acquire an aggregate of 1,442,334,553 Class B Shares. No share options and RSUs had been granted to the Directors. No further option could be granted under the Pre-IPO ESOP after the Listing.

DIRECTOR'S REPORT

Details of movements of share options and RSUs granted under the Pre-IPO ESOP during the year ended December 31, 2018 are as follows:

			Number of share options (adjusted after taking into account the share subdivision which took place on June 17, 2018)					
Grantees in aggregate	Dates of grant	Vesting period	Outstanding as of January 1, 2018	Granted during the Year	Cancelled/ Lapsed during the Year	Transferred to Share Scheme Trusts during the Year	Outstanding as of December 31, 2018	Exercise price (US$)
7,126	Between April 1, 2010 to June 14, 2018	1-10 years	2,142,480,580	425,005,610	76,345,390	1,048,806,247	1,442,334,553	0 to 0.34

Further details of the Pre-IPO ESOP are set out in Note 28 to the consolidated financial statements.

2. Post-IPO Share Option Scheme

The following is a summary of the principal terms of the Post-IPO Share Option Scheme adopted by the Company on June 17, 2018.

(a) Purpose

The purpose of the Post-IPO Share Option Scheme is to provide selected participants with the opportunity to acquire proprietary interests in the Company and to encourage selected participants to work towards enhancing the value of our Company and its Shares for the benefit of our Company and the Shareholders as a whole. The Post-IPO Share Option Scheme will provide our Company with a flexible means of retaining, incentivizing, rewarding, remunerating, compensating and/or providing benefits to selected participants.

(b) Eligible participants

Eligible participants under the Post-IPO Share Option Scheme include any employee, director, officer, consultant, advisor, distributor, contractor, customer, supplier, agent, business partner, joint venture business partner or service provider of any member of the Group or any affiliate as the Board determines.

(c) Maximum number of shares available for issue

The total number of Class B Shares which may be issued upon exercise of all share options to be granted under the Post-IPO Share Option Scheme and any other schemes is 2,237,613,083 Class B Shares, being no more than 10% of the Class B Shares in issue on the Listing Date. The overall limit on the number of Shares which may be issued upon exercise of all outstanding share options granted and yet to be exercised under the Post-IPO Share Option Scheme and any other share option schemes of the Company at any time (and to which the provisions of Chapter 17 of the Listing Rules are applicable) must not exceed 30% of the Class B Shares in issue from time to time.

(d) Maximum entitlement of each participant

Unless approved by shareholders of the Company, the total number of Class B Shares issued and to be issued upon exercise of the options granted and to be granted under the Post-IPO Share Option Scheme and any other share option scheme(s) of the Company to each selected participant (including both exercised and outstanding options) in any 12-month period shall not exceed 1% of the total number of Class B Shares in issue. Any further grant of options to a selected participant which would result in the aggregate number of Class B Shares issued and to be issued upon exercise of all options granted and to be granted to such selected participant (including exercised, cancelled and outstanding options) in the 12 month period up to and including the date if such further grant exceeding the individual limit shall be subject to separate approval of shareholders of the Company (with such selected participant and his associates abstaining from voting).

DIRECTOR'S REPORT

(e) **Grant of option and option period**

An offer shall be deemed to have been accepted and the option to which the offer relates shall be deemed to have been granted and to have taken effect when the duplicate of the offer letter comprising acceptance of the offer duly signed by the grantee with the number of Class B Shares in respect of which the offer is accepted clearly stated therein, together with a remittance in favor of the Company of HK$1.00 by way of consideration for the grant thereof, which must be received by the Company within 20 business days from the date on which the offer letter is delivered to the grantee. To the extent that the offer is not accepted within 20 business days from the date on which the letter containing the offer is delivered to that selected participant, it shall be deemed to have been irrecoverably declined.

An option may, subject to the terms and conditions upon which such option is granted, be exercised in whole or in part by the grantee giving notice in writing to the Company in such form as the Board may from time to time determine stating that the option is thereby exercised and the number of Class B Shares in respect of which it is exercised.

The Post-IPO Share Option Scheme does not set out any performance targets that must be achieved before the options may be exercised. However, the Board or its delegate(s) may at their sole discretion specify, as part of the terms and conditions of any option, such performance conditions that must be satisfied before the option can be exercised.

(f) **Exercise price**

The exercise price under an option shall be determined by the Board but shall be not less than the greater of:

(i) the closing price of a Class B Share as stated in the daily quotations sheet issued by the Stock Exchange on the date of grant;

(ii) the average closing price of the Class B Shares as stated in the daily quotations sheets issued by the Stock Exchange for the five business days immediately preceding the date of grant; and

(iii) the nominal value of a Class B Share on the date of grant.

(g) **Remaining life of the scheme**

The Post-IPO Share Option Scheme shall be valid and effective for the period of ten years commencing on the Listing Date.

As of December 31, 2018, no options had been granted or agreed to be granted pursuant to the Post-IPO Share Option Scheme since its adoption. The total number of Class B Shares available for grant under the Post-IPO Share Option Scheme was 2,237,613,083 Class B Shares, representing approximately 9.35% of the issued share capital of the Company as of the date of this annual report.

3. XMF Share Option Schemes

Unless otherwise defined below, terms used in this sub-section shall have the same meaning as those defined in the section headed "Definitions":

"Xiaomi Finance Group"	Xiaomi Finance, its subsidiaries and consolidated affiliated entities.
"XMF Board"	the board of directors of Xiaomi Finance (or if Xiaomi Finance has only a sole director, that director) or a committee thereof duly appointed for the purpose of administering the XMF Share Option Schemes.
"XMF Share Options Schemes"	XMF Share Options Scheme I and XMF Share Options Scheme II.
"XMF Shares"	ordinary share(s) in the share capital of Xiaomi Finance of nominal value of US$0.0001, or if there has been a subsequent sub-division, reduction, consolidation, reclassification or reconstruction of the share capital of Xiaomi Finance, the shares in the ordinary share capital of Xiaomi Finance resulting from such sub-division, reduction, consolidation, reclassification or reconstruction.
"XMF Subscription Price"	The price per XMF Share at which a grantee may subscribe for XMF Shares on the exercise of an option under the XMF Share Option Schemes.

Details	XMF Share Option Scheme I	XMF Share Option Scheme II
1. Purposes	To provide selected participants with the opportunity to acquire proprietary interests in Xiaomi Finance and to encourage the selected participants to work towards enhancing the value of Xiaomi Finance for the benefit of its shareholders.	To provide selected participants with the opportunity to acquire proprietary interests in Xiaomi Finance and to encourage the selected participants to work towards enhancing the value of Xiaomi Finance for the benefit of its shareholders.

DIRECTOR'S REPORT

Details	XMF Share Option Scheme I	XMF Share Option Scheme II
2. Eligible participants	Any directors and employees of any member of Xiaomi Finance Group (including nominees and/or trustees of any employee benefit trusts established for them) or any associates as the XMF Board determines.	Any individual, being an employee, director, officer, consultant, advisor, distributor, contractor, customer, supplier, agent, business partner, joint venture business partner or service provider of any member of the Xiaomi Finance Group or any of the Xiaomi Finance Group's affiliates as the XMF Board or its delegates determines.
3. Maximum number of shares available for issue	The overall limit on the number of XMF Shares that may be issued upon exercise of all outstanding options granted and yet to be exercised under the XMF Share Option Scheme I at any time shall not exceed 42,070,000 XMF Shares subject to any adjustments for share subdivisions or other dilutive issuances.	The maximum number of XMF shares represented by the options to be issued under the XMF Share Option Schemes shall be 150,000,000 XMF Shares.
4. Maximum entitlement of each participant	There is no maximum entitlement of each participant.	There is no maximum entitlement of a grantee, save that no options shall be granted to Lei Jun (or entities controlled by him) if such grant would result in Lei Jun's effective interest in Xiaomi Finance exceeding 28.0467% (being the effective equity interest of Lei Jun in the share capital of our Company on the Listing Date).

Details	XMF Share Option Scheme I	XMF Share Option Scheme II
5. Option period	An option may be exercised in accordance with the terms at any time during a period to be determined and notified by the XMF Board to each grantee at the time of grant, which shall end not later than 20 years from the date of grant of the option.	An option may, subject to the rules of the XMF Share Option Scheme II and the terms and conditions upon which such option is granted, be exercised in whole or in part by the grantee giving notice in writing to Xiaomi Finance in such form as the XMF Board may from time to time determine stating that the option is thereby exercised and the number of XMF Shares in respect of which it is exercised. The XMF Board has the authority to determine and to include in a grant offer letter the minimum period for which an option must be held before it can vest. The XMF Share Option Scheme II does not specify any minimum holding period.

DIRECTOR'S REPORT

Details	XMF Share Option Scheme I	XMF Share Option Scheme II
6. XMF Subscription Price	The XMF Subscription Price shall be determined by the XMF Board and shall not be less than the per XMF Share valuation based on the most recent appraised value of Xiaomi Finance prior to the adoption of the scheme, which is RMB3.8325 per XMF Share.	The XMF Subscription Price shall not be less than the nominal value of a XMF Share or the per XMF Share valuation based on the most recent appraised value of Xiaomi Finance prior to the Listing Date, which is RMB3.8325 per XMF Share. An offer shall be deemed to have been accepted and the option to which the offer relates shall be deemed to have been granted and to have taken effect when the duplicate of the grant offer letter comprising acceptance of the offer duly signed by the grantee with the number of XMF Shares in respect of which the offer is accepted clearly stated therein, together with a remittance in favor of Xiaomi Finance of HK$1.00 by way of consideration for the grant thereof, which must be received by Xiaomi Finance within 20 business days from the date on which the grant offer letter is delivered to the grantee.
7. Remaining life of the scheme	It will remain in force from June 17, 2018 until July 9, 2018, both dates inclusive. No further options will be offered or granted after the Listing Date.	It will remain valid and effective for the period of 10 years starting from the Listing Date.

As of December 31, 2018, there were a total of 42,070,000 outstanding share options granted under the XMF Share Option Scheme I. Details of movements of share options granted under the XMF Share Option Scheme I during the year ended December 31, 2018 are as follows:

Name	Date of grant	Option period	Number of XMF Shares represented by the options granted	Number of options exercised during the year	Numbers of options as of December 31, 2018	Subscription price
Lei Jun	June 17, 2018	20 years from the date of grant	42,070,000	—	42,070,000	RMB3.8325

As of December 31, 2018, no options had been granted or agreed to be granted pursuant to the XMF Share Option Scheme II since its adoption. The total number of XMF Shares available for grant under the XMF Share Option Scheme II was 107,930,000 XMF Shares, representing 107.93% of the issued share capital of Xiaomi Finance as of the date of this annual report and 43.17% of the issued share capital of Xiaomi Finance assuming options representing the maximum number of XMF Shares under the XMF Share Option Schemes have been granted and fully exercised.

4. Pinecone Share Option Schemes

Unless otherwise defined below, terms used in this sub-section shall have the same meaning as those defined in the section headed "Definitions":

"Pinecone Board"	the board of directors of Pinecone International
"Pinecone Group"	Pinecone International, its subsidiaries and consolidated affiliated entities.
"Pinecone Options"	share options granted under the Pinecone Share Option Scheme I.
"Pinecone Share Awards"	restricted or unrestricted share awards granted under the Pinecone Share Option Scheme I.
"Pinecone Ordinary Shares"	ordinary share(s) in the share capital of Pinecone International of nominal value of US$0.0001.
"Pinecone Subscription Price"	The price per Pinecone Ordinary Share at which a grantee may subscribe for Pinecone Ordinary Shares on the exercise of an option under the Pinecone Share Option Scheme II.

DIRECTOR'S REPORT

Details	Pinecone Share Option Scheme I	Pinecone Share Option Scheme II
1. Purposes	To promote the success of the Pinecone International and the interests of its shareholders by providing a means through which the Pinecone International may grant equity-based incentives to attract, motivate, retain and reward certain officers, employees, directors and other eligible persons and to further link the interests of awarded recipients with those of Pinecone International's shareholders generally.	To provide selected participants with the opportunity to acquire proprietary interests in Pinecone International and to encourage selected participants to work towards enhancing the value of Pinecone International and its shares for the benefit of Pinecone International and its shareholders, including our Company, as a whole.
2. Eligible participants	Any officer (whether or not a director) or employee, any director of Pinecone Group, or any individual consultant or advisor who renders or has rendered bona fide services (with certain exceptions) to Pinecone Group as one or more committees appointed by the Pinecone Board determine. Selected eligible participants may be granted awards in the form of Pinecone Options or Pinecone Share Awards.	Any individual, being an employee, director, officer, consultant, advisor, distributor, contractor, customer, supplier, agent, business partner, joint venture business partner or service provider of any member of the Pinecone Group or any affiliate as the Pinecone Board or its delegates determines.

Details	Pinecone Share Option Scheme I	Pinecone Share Option Scheme II
3. Maximum number of shares available for issue	The total number of underlying shares which may be issued upon exercise of all options granted pursuant to the Pinecone Share Option Scheme I is 9,532,868 Pinecone Ordinary Shares.	The total number of shares that may be issued upon exercise of all options to be granted under the Pinecone Share Option Scheme II and any other schemes is 2,467,132 Pinecone Ordinary Shares. The overall limit on the number of Pinecone Ordinary Shares that may be issued upon exercise of all outstanding options granted and yet to be exercised under the Pinecone Share Option Scheme II and any other schemes at any time must not exceed 48% of the Pinecone Ordinary Shares in issue from time to time.
4. Maximum entitlement of each participant	There is no maximum entitlement of each participant.	The total number of Pinecone Ordinary Shares issued and to be issued upon exercise of the options granted and to be granted under Pinecone Share Option Scheme II and other share option scheme(s) of Pinecone International to each selected participant (including both exercised and outstanding options) in any 12-month period shall not exceed 1.0% of the total number of Pinecone Ordinary Shares in issue

DIRECTOR'S REPORT

Details	Pinecone Share Option Scheme I	Pinecone Share Option Scheme II
5. Option period	A Pinecone Option may be exercised only to the extent that it is vested and exercisable, subject to the vesting and exercisability provisions as determined by the board of Pinecone International, provided the term of any Pinecone Option granted shall not exceed ten years. A Pinecone Share Award shall either vest or be repurchased by the Company as provided by the Pinecone Share Option Scheme I, not more than 10 years after the date of grant.	An option may, subject to the terms and conditions upon which such option is granted, be exercised in whole or in part by the grantee giving notice in writing to Pinecone International in such form as the board of Pinecone International may from time to time determine, stating that the option is thereby exercised and the number of shares in respect of which it is exercised. The Pinecone Board has the authority to determine and to include in a grant offer letter the minimum period for which an option must be held before it can vest. The Pinecone Share Option Scheme II does not specify any minimum holding period.

Details	Pinecone Share Option Scheme I	Pinecone Share Option Scheme II
6. Exercise Price	The exercise price must not be lower than the par value of the underlying Pinecone Ordinary Share, and in certain circumstances must not be lower than defined multiples of the fair market value of the underlying Pinecone Ordinary Shares. The Pinecone Board will determine the purchase price per Pinecone Ordinary Share covered by each Pinecone Share Award at the time of grant of the Pinecone Award. In no case will such purchase price be less than the par value of the Pinecone Ordinary Shares.	The Pinecone Subscription Price shall be determined by the Pinecone Board in relation to each option at the time of grant and specify the Pinecone Subscription Price in the grant offer letter. An offer shall be deemed to have been accepted and the option to which the offer relates shall be deemed to have been granted and to have taken effect when the duplicate of the grant offer letter comprising acceptance of the offer duly signed by the grantee with the number of Pinecone Ordinary Shares in respect of which the offer is accepted clearly stated therein, together with a remittance in favor of Pinecone International of HK$1.00 by way of consideration for the grant thereof, which must be received by Pinecone International within 20 business days from the date on which the grant offer letter is delivered to the grantee.
7. Remaining life of the scheme	It commenced on July 30, 2015 and will expire on the tenth anniversary thereof.	It shall be valid and effective for the period of 10 years commencing July 9, 2018.

DIRECTOR'S REPORT

As of December 31, 2018, there are 9,257,842 outstanding Pinecone Options granted to 177 participants under the Pinecone Share Option Scheme I. The aggregate number of underlying Pinecone Ordinary Shares pursuant to the Pinecone Options granted is 9,532,868 Pinecone Ordinary Shares. All Pinecone Options were granted between May 18, 2015 and June 8, 2018. The exercise price of all Pinecone Options that have been granted is between US$0.0001 to US$1.0377. All granted Pinecone Options vest on the second anniversary, third and fourth anniversary of the grant date as to 50%, 25% and 25%, respectively. No Pinecone Options have been granted to Directors, senior managers or other connected persons of the Company. Pinecone International will not make any further grants of Pinecone Options under the Pinecone Share Option Scheme I after the Listing Date. All shares underlying the Pinecone Options are Pinecone Ordinary Shares.

Details of movements of Pinecone Options under the Pinecone Share Option Scheme I during the year ended December 31, 2018 are as follows:

			Number of share options				
Grantees in aggregate	Dates of grant	Vesting period	Outstanding as of January 1, 2018	Granted during the Year	Cancelled/ Lapsed during the Year	Outstanding as of December 31, 2018	Exercise price (US$)
177	Between May 18, 2015 to June 8, 2018	4 years	2,920,864	6,879,120	542,142	9,257,842	0.0001 to 1.0377

As of December 31, 2018, no options under the Pinecone Share Option Scheme II had been granted or agreed to be granted since its adoption. The total number of Pinecone Ordinary Shares available for grant under the Pinecone Share Option Scheme II was 2,467,132 Pinecone Ordinary Shares, representing 9.87% of the issued share capital of Pinecone International as of the date of this annual report.

Share Award Scheme

The following is summary of the principal terms of the Share Award Scheme adopted by the Company on June 17, 2018.

1. Purpose

The purpose of the Share Award Scheme are (1) to align the interests of eligible persons with those of the Group through ownership of Class B Shares, dividends and other distributions paid on Shares and/or the increase in value of the Class B Shares, and (2) to encourage and retain eligible persons to make contributions to the long-term growth and profits of the Group.

2. Eligible participants

The eligible participants include any individual, being an employee, director (including executive Directors, non-executive Directors and independent non-executive Directors), officer, consultant, advisor, distributor, contractor, customer, supplier, agent, business partner, joint venture business partner or service provider of any member of the Group or any affiliate as the Board determines.

3. Maximum number of shares available for award

The aggregate number of Class B Shares underlying all grants made pursuant to the Share Award Scheme will not exceed 1,118,806,541 Shares without Shareholders' approval subject to an annual limit of 3% of the total number of issued Shares at the relevant time.

4. Maximum entitlement of each participant

There is no maximum entitlement of each participant.

5. Restrictions on grants

The Board and its delegate(s) may not grant any award ("**Award**") in the form of Class B Shares pursuant to the Share Award Scheme (the "**Award Shares**") to any selected participant in any of the following circumstances:

(i) where any requisite approval from any applicable regulatory authorities has not been granted;

(ii) where any member of the Group will be required under applicable securities laws, rules or regulations to issue a prospectus or other offer documents in respect of such Award or the Share Award Scheme, unless the Board determines otherwise;

DIRECTOR'S REPORT

(iii) where such Award would result in a breach by any member of the Group or its directors of any applicable securities laws, rules or regulations in any jurisdiction;

(iv) where such grant of Award would result in a breach of the Share Award Scheme limit or would otherwise cause the Company to issue Class B Shares in excess of the permitted amount in the mandate approved by the Shareholders;

(v) where any Director is in possession of unpublished inside information in relation to the Company or where dealings by Directors are prohibited under any code or requirement of the Listing Rules and all applicable laws, rules or regulations;

(vi) during the period of 60 days immediately preceding the publication date of the annual results or, if shorter, the period from the end of the relevant financial year up to the publication date of the results; and

(vii) during the period of 30 days immediately preceding the publication date of the half-year results or, if shorter, the period from the end of the relevant half-year period up to the publication date of the results.

6. Vesting and lapse

The Board or its delegate(s) may from time to time while the Share Award Scheme is in force and subject to all applicable laws, determine such vesting criteria and conditions or periods for the Award Shares to be vested/lapsed.

7. Rights attached to the Award Shares

Save that the Board at its discretion may from time to time determine that any dividends declared and paid by the Company in relation to the Award Shares be paid to the selected participants even though the Award Shares have not yet vested, the selected participant only has a contingent interest in the Award Shares underlying an Award unless and until such Award Shares are actually transferred to the selected participant, nor does he/she have any rights to any related income until the Award Shares vest.

No voting rights may be exercised in respect of any Award Shares that have not yet vested.

8. Duration and Termination

The Share Award Scheme shall terminate on the earlier of:

(i) the end of the period of ten years commencing on the Listing Date except in respect of any non-vested Award Shares granted under the Share Award Scheme prior to the expiration of the Share Award Scheme, for the purpose of giving effect to the vesting of such Award Shares or otherwise as may be required in accordance with the provisions of the Share Award Scheme; and

(ii) such date of early termination as determined by the Board provided that such termination shall not affect any subsisting rights of any selected participant under the rules of the Share Award Scheme, provided further that for the avoidance of doubt, the change in the subsisting rights of a selected participant in this paragraph refers solely to any change in the rights in respect of the Award Shares already granted to a selected participant.

As of December 31, 2018, no Class B Shares had been granted or agreed to be granted under the Share Award Scheme.

Equity-Linked Agreements

Save as disclosed in the sections headed "Share Option Schemes" and "Share Award Scheme", no equity-linked agreements were entered into by the Group, or existed during the year ended December 31, 2018.

DIRECTOR'S REPORT

Directors and Senior Management

The Directors of the Company during the year and up to the date of the annual report were:

Executive Directors

Lei Jun
Lin Bin

Non-Executive Directors

Koh Tuck Lye
Liu Qin

Independent Non-Executive Directors

Chen Dongsheng *(appointed on June 25, 2018)*
Lee Ka Kit *(appointed on June 25, 2018)*
Wong Shun Tak *(appointed on June 25, 2018)*

The Company has received from each independent non-executive Director an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules and the Board considers them independent.

Biographical Details and Other Information of the Directors

Lei Jun (雷軍), aged 49, is an executive Director, the founder of the Company, the Chairman and the Chief Executive Officer. He is also a member of the Remuneration Committee. Lei Jun is overall responsible for the Company's strategy, company culture and key products. He oversees the senior management team. Lei Jun currently holds directorships in various subsidiaries, Consolidated Affiliated Entities and operating entities of the Group.

Lei Jun is a renowned angel investor in mainland China. Lei Jun joined Kingsoft Corporation Limited (HKEx Stock Code: 3888) in 1992 and has held various senior positions in Kingsoft, including as the chairman of the board since July 2011, non-executive director since August 2008 and the chief executive officer between 1998 and December 2007. From July 2011 to March 2018, Lei Jun was the chairman of Cheetah Mobile Inc. (NYSE ticker: CMCM). From July 2011 to August 2016, Lei Jun was the chairman of YY Inc. (NASDAQ ticker: YY).

Lei Jun received a bachelor's degree in computer science from Wuhan University (武漢大學) on July 1, 1991. He has been a member of the board of Wuhan University since November 2003. Lei Jun has also been serving as vice chairman of All-China Federation of Industry and Commerce (中華全國工商業聯合會) since November 2017 and vice president of China Quality Association (中國質量協會) since December 2017.

Lei Jun was elected as one of the top 10 economic personages of China in 2017, and one of 100 outstanding private entrepreneurs on the 40th anniversary of the China's reform and opening-up.

Lin Bin (林斌), aged 51, is an executive Director, a Co-founder and the President. He is also a member of the Nomination Committee. He is responsible for the Company's smartphone business. Lin Bin currently holds directorships in various major subsidiaries of the Group.

Before joining the Group in 2010, Lin Bin had served as an engineering director at Google Inc. between 2006 and 2010. Before this, he had worked at Microsoft Corporation from 1995 to 2006, including as an engineering director at Microsoft (China) Limited from 2003 to 2006. Prior to this, Lin Bin worked as Network Engineer at ADP Inc. since May 1993.

Lin Bin has held numerous visiting and adjunct professorships, including visiting professor at Zhejiang University (浙江大學) in 2002, visiting professor at Tongji University (同濟大學) in 2002, adjunct professor at Nankai University (南開大學) from 2002 to 2005 and adjunct professor at Sun Yat-sen (中山大學) University from 2005 to 2008. He currently sits on the Board of Advisors of the Tufts University School of Engineering.

Lin Bin received a bachelor's degree of science in radio electronics from Sun Yat-sen University (中山大學) in July 1990, and a Master of Science from Drexel University in June 1992.

Koh Tuck Lye (許達來), aged 47, is a non-executive Director and currently holds directorships in various subsidiaries of the Company. He is also a member of the Audit Committee. Koh Tuck Lye became our Director since August 2013. Koh Tuck Lye has served as a co-founder and the chief executive officer of Shunwei Capital since April 2011. From June 2009 to March 2011, he served as managing director in investment at Beijing C.V. Starr Investment Advisors Limited (北京世威史帶投資顧問有限公司). Prior to this, Koh Tuck Lye served as vice president responsible for private investments in greater China at GIC Special Investments (Beijing) Company Ltd.. Koh Tuck Lye also served as a director at Kingsoft from August 2006 to May 2008.

Koh Tuck Lye received a bachelor's degree in mechanical engineering from National University of Singapore on July 23, 1996, and a master of science in industrial engineering (engineering management) from Stanford University on September 23, 1999. Koh Tuck Lye was also accredited as a chartered financial analyst by Association for Investment Management and Research (now known as the CFA Institute) on October 11, 2000.

Liu Qin (劉芹), former name: Liu Ya (劉雅), aged 46, is a non-executive Director and currently holds directorships in various major subsidiaries of the Company. Liu Qin became our Director since May 2010. Liu Qin co-founded and has served as managing director of Morningside Venture Capital Limited ("**MSVC**") since June 2007. The funds under MSVC's management had been the earliest investors of the Group. Before co-founding MSVC, Liu Qin served various roles including as a business development director for investment at Morningside IT Management Services (Shanghai) Co. Ltd. (晨興信息科技諮詢（上海）有限公司) from July 2000 to November 2008. Liu Qin has been a director of YY Inc. (NASDAQ ticker: YY) since June 2008, and a director of Xunlei Limited (NASDAQ ticker: XNET) since September 2005.

DIRECTOR'S REPORT

Liu Qin received a bachelor's degree in industrial electrical automation from University of Science and Technology Beijing (北京科技大學) in July 1993, and a master's degree in business administration from China Europe International Business School (中歐國際工商學院) on April 22, 2000.

Chen Dongsheng (陳東升), aged 61, has been appointed as an independent non-executive Director with effect from June 25, 2018. He is also the chairman of both the Remuneration Committee and the Corporate Governance Committee, and a member of the Audit Committee. Chen Dongsheng has served as the chairman of Taikang Insurance Group Inc. (泰康保險集團股份有限公司) (formerly known as Taiking Life Insurance Co., Ltd (泰康人壽保險股份有限公司)) ("**Taikang**") since July 1996. He is currently the chief executive officer of Taikang and holds various directorships within the Taikang group. Prior to this, Chen Dongsheng served as the chairman and the general manager of China Guardian Auctions Co., Ltd (中國嘉德國際拍賣有限公司) from May 1993. Prior to this, Chen Dongsheng worked as the deputy editor of the Management World (monthly), published by the Development Research Center of the State Council of China.

Chen Dongsheng has accumulated extensive corporate governance experience during his leadership in the Taikang group, as he oversaw the reform of the group's corporate governance structure and its continuous optimization. Key corporate governance initiatives implemented during Chen Dongsheng's tenure include (i) formalizing the structure, functions and accountability of the corporate governance bodies within the Taikang group, (ii) introducing board executive, audit, nomination and remuneration committees, the members of which are selected by election, and (iii) appointing independent directors.

Chen Dongsheng received a bachelor's degree in political economics on July 30, 1983, and a PhD in political economics on June 30, 1996, both from Wuhan University (武漢大學).

Lee Ka Kit (李家傑), GBS, JP, DBA (Hon), aged 55, has been appointed as an independent non-executive Director with effect from June 25, 2018. He is also the chairman of the Nomination Committee and a member of the Corporate Governance Committee. Lee Ka Kit has served as an executive director of Henderson Land Development Company Limited (HKEx Stock Code: 0012) since 1985 and as its vice chairman since 1993, primarily responsible for the development of the PRC business of Henderson Land Group. He has also served as an executive director and the vice chairman of Henderson Investment Limited (HKEx Stock Code: 0097) since 1993, as well as the vice chairman of Henderson Development Limited. Lee Ka Kit currently holds directorships in The Bank of East Asia, Limited (HKEx Stock Code: 0023), as a non-executive director since May 2013, and The Hong Kong and China Gas Company Limited (HKEx Stock Code: 0003), as a non-executive director since March 1990.

Lee Ka Kit acquired extensive experience in dealing with corporate governance issues through his positions as director and member of board committee in numerous Hong Kong listed companies. Lee Ka Kit's experience includes (i) reviewing, monitoring and making recommendations as to the companies' policies, practices and compliance, and (ii) implement measures to ensure effective communication between the board and shareholders. As a result, Lee Ka Kit has undergone training and experience in implementing relevant Listing Rule requirements and director's duties.

Lee Ka Kit has been appointed as a Justice of the Peace in 2009 and was awarded the Gold Bauhinia Star in 2015 by the Government of the Hong Kong Special Administrative Region.

Lee Ka Kit was awarded an Honorary University Fellowship by The University of Hong Kong in September 2009 and an Honorary Degree of Doctor of Business Administration by Edinburgh Napier University on July 3, 2014.

Wong Shun Tak (王舜德), aged 58, currently serves as an independent non-executive Director, the chairman of the Audit Committee, a member of the Remuneration Committee, Corporate Governance Committee and Nomination Committee. Mr. Wong is a co-founder and the chief financial officer of Rokid Corporation Ltd, an artificial intelligence devices design and development company. Mr. Wong served as an executive director and chief financial officer of Kingsoft Corporation Limited (HKEx Stock Code: 3888) from October 2011 to July 2012, and also acted as an independent non-executive director, chairman of the audit committee and member of the remuneration committee of Kingsoft from April 2007 to September 2011. Mr. Wong has served as an independent non-executive Director and chairman of the Audit Committee of the Company since June 2018.

Mr. Wong was vice president for finance and financial controller of Alibaba Group Holding Ltd (NYSE ticker: BABA) from August 2007 to September 2011, an enterprise which engages in internet based businesses that include business-to-business international trade, retail and payment platforms and data-centric cloud computing services. During his service with Alibaba Group, he also acted as chairman of Group Financial Control Committee of Alibaba Group.

Wong Shun Tak served as the chief financial officer of Goodbaby Children Products Group ("**Goodbaby**") from August 2003 to August 2007, a leading juvenile product manufacturer in China. Before joining Goodbaby, Mr. Wong worked as the vice president for finance in IDT International Limited (HKEx Stock Code: 167) between September 2001 and July 2003.

In the past, Mr. Wong held key financial management positions in various multi-nationals companies, including as the financial controller of AMF Bowling, Inc. from November 1996 to March 1998 and International Distillers China Ltd. from December 1993 to October 1996. Mr. Wong has extensive experience in financial control, operations, strategic planning and implementation, private fund investments and exit strategies.

Mr. Wong has a master's degree in Finance from the University of Lancaster in the United Kingdom and a master's degree in Accounting from Charles Stuart University in Australia. He is also a fellow CPA member of the Hong Kong Institute of Certified Public Accountants and a fellow CPA member of Australian Society of CPAs.

DIRECTOR'S REPORT

Biographical Details of Senior Management

Chew Shou Zi (周受資), aged 36, is a Senior Vice President and the Chief Financial Officer and oversees the finance, investments and human resources functions of the Group. Before joining the Group in July 2015, Chew Shou Zi was a partner at DST Investment Management Ltd. and worked there from August 2011 to June 2015. Prior to DST Investment Management Ltd., Chew Shou Zi worked at Goldman Sachs International from July 2006 to July 2008.

Chew Shou Zi received a Bachelor of Science in Economics from University College London on August 1, 2006 and a Master of Business Administration from Harvard Business School on March 8, 2011.

Cui Baoqiu (崔寶秋), aged 49, is a Vice President and the Chairman of the Technical Committee of the Group and is responsible for technology development and research. Focusing on technology and engineering improvement, Cui Baoqiu makes decisions on the technology development of the Group and promotes the recruitment, training, advancement and incentives of technical staff. Before joining the Group in June 2012, Cui Baoqiu served as chief engineer/group leader at Linkedin Corporation from August 2010 to June 2012. Before that, Cui Baoqiu worked as lead engineer of the core team of Yahoo Search Technology at Yahoo! Inc from November 2006 to August 2010. Cui Baoqiu worked as senior engineer from August 2000 to July 2005, and as senior research and development manager from July 2005 to November 2006 at International Business Machines Corporation (NYSE: IBM).

Cui Baoqiu received a bachelor's degree and a master's degree in computer science from Wuhan University (武漢大學) in 1991 and 1994, respectively, and a PhD in computer science from the State University of New York at Stony Brook in 2000.

Hong Feng (洪鋒), aged 41, is a Co-founder and a Senior Vice President. He is currently the Chairman and chief executive officer of Xiaomi Finance, and responsible for the development of finance businesses of the Group. Prior to joining the Group in December 2010, Hong Feng held various positions at Google Inc. from May 2005 to December 2010, including as senior product manager. From May 2001 to May 2005 Hong Feng worked at Siebel Systems (which was subsequently acquired by Oracle America, Inc.) as lead software engineer.

Hong Feng received a bachelor's degree in computer and application from Shanghai Jiao Tong University (上海交通大學) in July 1999, and a Master of Science degree from Purdue University on May 5, 2001.

Jain Manu Kumar, aged 38, is a Vice President and the Managing Director of Xiaomi India. He is responsible for the Group's business in India. Jain Manu Kumar joined the Group in October 2014 and heads Xiaomi's business in India. Prior to January 2014, he worked at Jabong.com. Between June 2007 and December 2011, Jain Manu Kumar served in McKinsey & Company and held the position of Engagement Manager at the time of leaving.

Jain Manu Kumar received a bachelor's degree in mechanical engineering from Indian Institute of Technology Delhi on August 9, 2003, and a Post-Graduate Diploma in Management from Indian Institute of Management Calcutta in 2007.

Lei Jun (雷軍), aged 49, is the Founder, the Chief Executive Officer, the Chairman and an executive Director. For further details, please see the paragraphs headed "Biographical Details and Other Information of the Directors" in this section.

Li Wanqiang (黎萬强), aged 42, is a Co-founder, a Senior Vice President and the Brand Strategy Officer. He is responsible for the Group's branding, marketing and communication strategy. Before joining the Group in March 2010, Li Wanqiang held several positions in Kingsoft between June 2000 and January 2010, including as the general manager.

Li Wanqiang received a bachelor's degree in industrial design from Xi'an Polytechnic University (西安工程大學) (formerly known as the Northwest Textile Institute (西北紡織工學院)), on July 3, 2000.

Lin Bin (林斌), aged 51, is a Co-founder, the President and an executive Director. For further details, please see the paragraphs headed "Biographical Details and Other Information of the Directors" in this section.

Liu De (劉德), aged 45, is a Co-founder, Senior Vice President and Head of Group Organization Department, currently responsible for the recruitment, promotion, training and assessment of the middle and senior management of the Group, as well as the organizational structure design and approval procedures of each department. In October 2002 Liu De co-founded Beijing Xinfengrui Industrial Design Co., Ltd. (北京新鋒銳工業設計公司) and served as its executive director.

Liu De received a bachelor's degree in industrial design on July 1, 1996 and a master's degree in mechanical design and theory on March 27, 2001, both from the Beijing Institute of Technology (北京理工大學). Liu De was awarded a master's degree in industrial design from Art Center College of Design, Pasadena, California, US, on April 24, 2010.

Lu Weibing (盧偉冰), aged 43, is a Vice President, and the General Manager of Redmi, responsible for the brand strategy, product planning, production, sales and marketing of Redmi. Before joining the Group in January 2019, Lu Weibing served as chairman and president of Shenzhen Chenyee Technology Co., Ltd. (深圳市誠壹科技有限公司) from June 2017 to December 2018. From April 2010 to June 2017, Lu Weibing served as president at Shenzhen Gionee Communication Equipment Co., Ltd. (深圳市金立通信設備有限公司). Before this, Lu Weibing worked as general manager of the overseas department at Tianyu Communication Equipment Co., Ltd. (北京天宇朗通通信設備有限公司) from January 2008 to March 2010. Lu Weibing worked as general sales manager at KONKA Communication Co., Ltd. (康佳通信科技有限公司) from July 1998 to December 2007.

DIRECTOR'S REPORT

Lu Weibing received a Bachelor of Science in chemistry from Tsinghua University (清華大學) in 1998 and an Executive Master of Business Administration from Cheung Kong Graduate School of Business in 2009.

Qi Yan (祁燕), aged 69, is a Senior Vice President, leading platform, internal operations and external public affairs of the Group. Before joining the Group in January 2013, Qi Yan served as the chief executive officer of Aigo Electronic Technology Co., Ltd. (愛國者電子科技有限公司) from September 2010 to December 2012, and the chief executive officer of Aigo Digital Technology Co., Ltd. (愛國者數碼科技有限公司) from September 2004 to September 2010. Qi Yan had served as the head of organizational section of the Beijing Municipal Committee of China National Democratic Construction Association (中國民主建國會) since May 1993, and was further appointed as the deputy secretary-general in December 1993. Between December 1993 and January 1997, Qi Yan also served as the principal of the Beijing Jianhua Experimental School (北京市建華實驗學校).

Qi Yan has served as an independent non-executive director of HC INTERNATIONAL, INC. (慧聰網有限公司) (HKEx Stock Code: 2280) since November 2017. She has also served as a director of Beijing Power Future Technology Co., Ltd. (北京動力未來科技股份有限公司) (National Equities Exchange and Quotations Stock Code: 839032) since November 2015.

Qi Yan received a master's degree in applied sociology from the Graduate School of Academy of Social Sciences (中國社會科學院研究生院) on June 30, 1998.

Shang Jin (尚進), aged 42, is a Vice President, currently responsible for assisting Senior Vice President Qi Yan with the planning and construction of Xiaomi's regional headquarters across mainland China. Before joining the Group in September 2014, Shang Jin co-founded and served as the chief executive officer of Beijing Kylin Culture Co., Ltd. (北京麒麟網文化股份有限公司) (formerly known as Beijing Kylin Information Technology Co, Ltd. (北京麒麟網信息科技有限公司)) between July 2007 and February 2014. Before this, Shang Jin served as vice general manager of Beijing AmazGame Age Internet Technology Co., Ltd. (北京暢游天下網絡技術有限公司) (subsequently listed as part of the group of Changyou.com Limited, NASDAQ ticker: CYOU) from February 2005. From November 1999 to February 2005, Shang Jin worked at Kingsoft, including as project manager, technology officer and division deputy manager.

Shang Jin has served as a director of Ourpalm Co., Ltd (北京掌趣科技股份有限公司) (Shenzhen Stock Exchange Stock Code: 300315) since February 2018.

In 2010, Shang Jin was awarded Zhongguancun's leading talent and in 2011 was named one of the top 10 most influential leaders in the gaming industry of the year. Shang Jin received a bachelor's degree in physics from Dalian University of Technology (大連理工), in July 1998.

Wang Chuan (王川), aged 49, is a Co-founder, a Senior Vice President, the Group Chief of Staff and President of Xiaomi, China region. He is responsible for assisting the CEO in formulating the Group's strategy and supervising the strategic execution of each business unit. He is also responsible for the overall development and management of the Group's business in China. Wang Chuan co-founded Beijing Duokan in February 2010, where he currently serves as the chief executive officer. Wang Chuan also founded Beijing Leishitiandi Electron Technology Co., Ltd. (北京雷石天地電子技術有限公司) in June 2006 and served as the chairman.

Wang Chuan has served as a director of Xunlei Limited (NASDAQ ticker: XNET) since March 2014 and its chairman of the board since December 2017. He has also served as a director of IQIYI, INC. (NASDAQ ticker: IQ) since November 2014, and as an independent non-executive director of Zhejiang Huace Film and TV Co., Ltd. (浙江華策影視股份有限公司) (Shenzhen Stock Exchange Stock Code: 300133).

Wang Chuan received a bachelor's degree in computer science and engineering from Beijing University of Technology (北京工業大學) on July 10, 1993.

Wang Xiang (王翔), aged 57, is a Senior Vice President, responsible for the Group's global business, intellectual property rights and legal affairs. Wang Xiang has over 20 years of experience in the semiconductor and communications industry. He previously served various roles at Qualcomm Wireless Semi Conductor Technologies Limited (a group member of QUALCOMM, Inc. (NASDAQ ticker: QCOM) ("**Qualcomm**")) between July 2002 and June 2015, including as the global senior vice president and the greater China president, overseeing the business of Qualcomm in the greater China region. Between April 1992 and November 2000, Wang Xiang served as manager at Motorola China Electronics Ltd. (摩托羅拉（中國）電子有限公司) (now known as Motorola Systems (China) Co., Ltd. (摩托羅拉系統（中國）有限公司)).

Wang Xiang received a bachelor's degree in radio electronics with a major in semiconductor physics and devices from Beijing University of Technology (北京工業大學) on July 14, 1984.

DIRECTOR'S REPORT

Yan Kesheng (顏克勝), aged 48, is a Vice President and the Chairman of the Quality Committee responsible for quality control of all hardwares and services of the Group. Before joining the Group in October 2010, Yan Kesheng was a senior mechanical design manager at Star Shine Tech Co., Ltd. (星耀無線科技有限公司) from October 2008 to October 2010. From October 2002 to October 2008, Yan Kesheng worked as chief structural design engineer and project leader at Motorola Technology Co., Ltd. (摩托羅拉科技有限公司). Before this, Yan Kesheng worked as senior mechanical engineer and design team leader at Vtech Telecommunications Limited (偉易達通訊設備有限公司) from December 1998 to October 2002 and as chief engineer at Hubei Yichang Nanyuan Vehicle Manufacturing Co., Ltd. (湖北宜昌南苑車輛製造有限公司) from July 1992 to November 1998.

Yan Kesheng received a bachelor's degree in agricultural machinery manufacturing and repair from Hefei University of Technology (合肥工業大學) (formerly known as Anhui Institute of Technology (安徽工學院)) in July 1992.

Zhang Feng (張峰), aged 49, is a Vice President, responsible for managing all crucial aspects of the supply chain processes for the Group's smartphone business. In 2013, Zhang Feng joined and served as the general manager at Jiangsu Zimi Electronic Technology Co., Ltd. (江蘇紫米電子技術有限公司), which developed power banks for the Company and became one of the Group's ecosystem partners. He held various positions in the Inventec group between September 1993 and February 2012, including as the director of research and development and the general manager of the group's Nanjing branch.

Zhang Feng received a bachelor's degree in radio electronics from Shanghai University of Science and Technology (上海科學技術大學) (now known as Shanghai University (上海大學)) in July 1991.

Director's Service Contracts and Appointment Letters

1. Executive Directors

Each of the executive Directors has entered into a service contract with our Company on June 19, 2018. The initial term of their service contracts shall commence from the date of his or her appointment and continue for a period of three years after or until the third annual general meeting of the Company since the Listing Date, whichever is earlier (subject always to re-election as and when required under the Articles of Association), until terminated in accordance with the terms and conditions of the service contract or by either party giving to the other not less than one months' prior notice in writing. No annual director's fees are payable to the executive Directors under the current arrangement.

2. **Non-executive Directors and independent non-executive Directors**

   Each of the non-executive Directors has entered into an appointment letter with our Company on June 19, 2018. The initial term for their appointment letters shall commence from the date of their appointments and shall continue for three years after or until the third annual general meeting of the Company since the Listing Date, whichever is sooner, (subject always to re-election as and when required under the Articles of Association) until terminated in accordance with the terms and conditions of the appointment letter or by either party giving to the other not less than one month's prior notice in writing. No annual directors fees are payable to the non-executive Directors under the current arrangement.

   Each of the independent non-executive Directors has entered into an appointment letter with our Company on June 19, 2018. The initial term for their appointment letters shall be three years from June 25, 2018 or until the third annual general meeting of the Company since the Listing Date, whichever is sooner, (subject always to re-election as and when required under the Articles of Association) until terminated in accordance with the terms and conditions of the appointment letter or by either party giving to the other not less than three months' prior notice in writing. Under these appointment letters, each of the independent non-executive Directors will receive an annual director's fee of HK$500,000.

Directors' Interests and Short Positions in Shares and Underlying Shares and Debentures of the Company or any of its Associated Corporations

As of December 31, 2018, the interests and short positions of our Directors or chief executives of the Company in the Shares, underlying Shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code were as follows:

DIRECTOR'S REPORT

1. Interest in Shares

Name of Director or chief executive	Nature of interest[6]	Relevant company	Number and class of securities	Approximate percentage of shareholding in the relevant class of Shares[1]
Lei Jun[2]	Beneficiary, founder and settlor of a Trust(L)	ARK Trust (Hong Kong) Limited	4,295,187,720 Class A Shares	64.15%
			2,661,517,010 Class B Shares	15.72%
	Interest in controlled corporations(L)	Smart Mobile Holdings Limited	4,295,187,720 Class A Shares	64.15%
			2,223,884,750 Class B Shares	13.13%
	Interest in controlled corporations(L)	Smart Player Limited	59,221,630 Class B Shares	0.35%
	Interest of a party to an agreement regarding interest in the Company(L)	N/A	378,410,630 Class B Shares	2.23%
Lin Bin[3]	Beneficial owner(L)	Company	91,233,610 Class B Shares	0.54%
	Trustee, beneficiary and settlor of a trust(L)	Bin Lin Trust	2,400,000,000 Class A Shares	35.85%
			300,000,000 Class B Shares	1.77%
Koh Tuck Lye[4]	Interest in controlled corporations(L)	Shunwei Ventures Limited	610,471,890 Class B Shares	3.61%
	Interest in controlled corporations(L)	Bright Inspiration Holdings Limited	5,000,000 Class B Shares	0.03%
	Interest in controlled corporation(L)	Gifted Jade Limited	3,377,000 Class B Shares	0.02%
Liu Qin[5]	Interest in controlled corporations(L)	Morningside China TMT Fund I, L.P.	2,438,349,780 Class B Shares	14.40%
	Interest in controlled corporations(L)	Morningside China TMT Fund II, L.P.	409,475,770 Class B Shares	2.42%

Notes:

(1) The calculation is based on the total number of relevant class of Shares in issue as of December 31, 2018.

(2) Smart Mobile Holdings Limited and Smart Player Limited are both wholly-owned by Sunrise Vision Holdings Limited which is in turn wholly-owned by Parkway Global Holdings Limited. The entire interests in Parkway Global Holdings Limited is held by ARK Trust (Hong Kong) Limited as trustee for a trust established by Lei Jun (as settlor) for the benefit of Lei Jun and his family. Accordingly, Lei Jun is deemed to be interested in 1) the 4,295,187,720 Class A Shares and the 2,223,884,750 Class B Shares held by Smart Mobile Holdings Limited; and 2) the 59,221,630 Class B Shares held by Smart Player Limited under the SFO. Pursuant to the voting proxy agreements, Lei Jun is entitled to exercise the right to vote on a total of 378,410,630 Class B Shares.

(3) Lin Bin holds 2,400,000,000 Class A Shares and 300,000,000 Class B Shares as trustee of the Bin Lin Trust, which was established by Lin Bin (as the settlor) for the benefit of Lin Bin and his family.

(4) Shunwei Ventures Limited is a wholly-owned subsidiary of Shunwei China Internet Fund, L.P. Shunwei Capital Partners GP, L.P. is the general partner of Shunwei China Internet Fund, L.P. Shunwei Capital Partners GP Limited is the general partner of Shunwei Capital Partners GP, L.P., which is in turn owned by Gifted Ventures Limited as to 75%. Bright Inspiration Holdings Limited is a wholly-owned subsidiary of Shunwei China Internet Fund III L.P. Shunwei Capital Partners III GP, L.P. is the general partner of Shunwei China Internet Fund III L.P. Shunwei Capital Partners III GP Limited is the general partner of Shunwei Capital Partners III GP, L.P., which is owned by Gifted Ventures Limited as to 75%. Gifted Ventures Limited is wholly-owned by Koh Tuck Lye. Gifted Jade Limited is also wholly-owned by Koh Tuck Lye. Koh Tuck Lye is therefore deemed to be interested in the total of 618,848,890 Class B Shares held by Shunwei Ventures Limited, Bright Inspiration Holdings Limited and Gifted Jade Limited under the SFO.

(5) Liu Qin is entitled to exercise or control the exercise of one-third of the voting power at general meetings of TMT General Partner Ltd. and is therefore deemed to be interested in the Shares in which TMT General Partner Ltd. is interested. TMT General Partner Ltd. controls Morningside China TMT GP, L.P. and Morningside China TMT GP II, L.P., which respectively controls Morningside China TMT Fund I, L.P. and Morningside China TMT Fund II, L.P. (the "**Morningside Funds**"). Consequently, TMT General Partner Ltd. is deemed to be interested in the Shares in which the Morningside Funds have an interest.

(6) The letter "L" denotes the person's long position in the shares.

DIRECTOR'S REPORT

2. Interest in associated corporations

Name of Director or chief executive	Nature of interest	Associated corporations	Approximate percentage of shareholding[1]
Lei Jun	Beneficial owner	Xiaomi Finance[2]	42.07%
	Interest in controlled corporations(L)	Parkway Global Holdings Limited[3]	100%
	Interest in controlled corporations(L)	Sunrise Vision Holdings Limited[3]	100%
	Interest in controlled corporations(L)	Smart Mobile Holdings Limited[3]	100%
	Interest in controlled corporation(L)	Shenzhen Pineapple Games Co., Ltd. (深圳市菠蘿遊戲有限公司)	0%
	Interest in controlled corporation(L)	Zimi International Incorporation[4]	9.43%
Koh Tuck Lye	Interest in controlled corporation(L)	Zimi International Incorporation[4]	21.25%
	Interest in controlled corporation(L)	SMARTMI International Ltd[5]	33.99%

Notes:

(1) The calculation is based on the total number of shares of the associated corporations in issue as of December 31, 2018.

(2) Xiaomi Finance is a subsidiary of the Company and therefore Xiaomi Finance is an associated corporation of the Company. Lei Jun is entitled to receive up to 42,070,000 shares in Xiaomi Finance pursuant to options granted to him under the XMF Share Option Scheme I (subject to the relevant vesting conditions).

(3) Smart Mobile Holdings Limited, the holding company of the Company, is wholly-owned by Sunrise Vision Holdings Limited which is in turn wholly-owned by Parkway Global Holdings Limited. Lei Jun is the beneficial owner of the entire interest in Smart Mobile Holdings Limited, and is deemed to be interested in the 4,295,187,720 Class A Shares and 2,223,884,750 Class B Shares held by Smart Mobile Holdings Limited under the SFO. Therefore, Smart Mobile Holdings Limited, Sunrise Vision Holdings Limited and Parkway Global Holdings Limited are associated corporations of the Company.

(4) As of December 31, 2018, the Company held 21.25% of the equity interest of Zimi International Incorporation, and Zimi International Incorporation is therefore an associated corporation of the Company. Koh Tuck Lye and Lei Jun are ultimately interested in Zimi International Incorporation as to approximately 21.25% (being 20,098,050, series A preferred shares and 2,000,000 series B preferred shares) and approximately 9.43% (being 9,803,900 ordinary shares), respectively.

(5) The Company is interested in 34.60% of the equity interest in SMARTMI International Ltd, and therefore SMARTMI International Ltd is an associated corporation of the Company. Koh Tuck Lye is ultimately interested in SMARTMI International Ltd as to approximately 33.99% (being 37,680,000 series A-1 preferred shares and 4,000,000 series A-2 preferred shares).

Save as disclosed above, as at December 31, 2018, so far as is known to any Director or the chief executive of the Company, none of the Directors nor the chief executives of the Company had any interests or short positions in the Shares, underlying Shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which (a) were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein; or (b) were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange.

Directors' Interests in Transactions, Arrangements or Contracts of Significance

Save as disclosed in this annual report, none of the Directors nor any entity connected with the Directors had a material interest, either directly or indirectly, in any transactions, arrangements or contracts of significance to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party subsisting during or at the end of the year ended December 31, 2018.

Permitted Indemnity Provision

Pursuant to the Articles of Association and subject to the applicable laws and regulations, every Director shall be indemnified out of the assets of the Company against all losses or liabilities incurred or sustained by him as a Director in defending any proceedings, whether civil or criminal, in which judgement is given in his favour, or in which he is acquitted.

Such permitted indemnity provision has been in force for the year ended December 31, 2018. The Company has taken out liability insurance for our Directors during the period from the Listing Date to December 31, 2018.

Directors' Rights to Acquire Shares or Debentures

Save as disclosed in this annual report, neither the Company nor its subsidiaries was a party to any arrangement that would enable the Directors to acquire benefits by means of acquisition of Shares in, or debentures of, the Company or any other body corporate, and none of the Directors or any of their spouses or children under the age of 18 were granted any right to subscribe for the equity or debt securities of the Company or any other body corporate or had exercised any such right at any time during the year ended December 31, 2018.

DIRECTOR'S REPORT

Directors' Interests in Competing Business

Lei Jun and Koh Tuck Lye are founding partners of Shunwei Capital ("**Shunwei**"), which operates investment funds specializing in incubation, start-ups, early to mid-stage and growth capital investments in Internet and technology industries. While Shunwei may acquire non-controlling interests in certain business that operate in technology and Internet sectors similar to those in which our Group operates, Shunwei is a pure capital investment company, and generally has no management or shareholding control over any of its investee companies. We therefore do not believe that Shunwei competes in any material way with our Group.

Save as disclosed in this annual report and except for the interests of the Controlling Shareholders in the Group, during the year ended December 31, 2018, neither the Controlling Shareholders nor any of the Directors had any interest in a business, apart from the business of the Group, which competes or is likely to compete, directly or indirectly, with the Group's business, which would require disclosure under Rule 8.10 of the Listing Rules.

Substantial Shareholders' Interests and Short Positions in Shares And Underlying Shares

As of December 31, 2018, so far as the Directors are aware, the following parties (other than our Directors or chief executive of the Company) had interests or short positions in the Shares or underlying Shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO:

Name of Substantial Shareholder	Nature of interest	Number of Shares	Approximate percentage of shareholding in the relevant class of Shares[1]
Class A Shares			
Smart Mobile Holdings Limited[2]	Beneficial interest	4,295,187,720	64.15%
Sunrise Vision Holdings Limited[2]	Interest in controlled corporations	4,295,187,720	64.15%
Parkway Global Holdings Limited[2]	Interest in controlled corporations	4,295,187,720	64.15%
ARK Trust (Hong Kong) Limited[2]	Trustee	4,295,187,720	64.15%

Name of Substantial Shareholder	Nature of interest	Number of Shares	Approximate percentage of shareholding in the relevant class of Shares[1]
Class B Shares			
Smart Mobile Holdings Limited[2]	Beneficial interest	2,223,884,750	13.13%
Sunrise Vision Holdings Limited[2]	Interest in controlled corporations	2,283,106,380	13.48%
Parkway Global Holdings Limited[2]	Interest in controlled corporations	2,283,106,380	13.48%
ARK Trust (Hong Kong) Limited[2]	Trustee	3,058,947,767	18.07%
Shi Jianming[4, 5]	Interest in controlled corporations	2,847,825,550	16.82%
Lou Yiting[5]	Interest of spouse	2,847,825,550	16.82%
Ni Yuanyuan[6]	Interest of spouse	2,847,825,550	16.82%
Landmark Trust Switzerland SA[4, 5]	Interest in controlled corporations	2,847,825,550	16.82%
Morningside-Springfield Group Limited[3, 4]	Interest in controlled corporations	2,847,825,550	16.82%
Morningside Group International Limited[3,4]	Interest in controlled corporations	2,847,825,550	16.82%
Morningside Ventures Limited[3, 4]	Interest in controlled corporations	2,847,825,550	16.82%
Morningside Venture (VII) Investments Limited[3, 4]	Interest in controlled corporations	2,847,825,550	16.82%
TMT General Partner Ltd.[3, 4]	Interest in controlled corporations	2,847,825,550	16.82%
Morningside China TMT GP, L.P.[3]	Interest in a controlled corporation	2,438,349,780	14.40%
Morningside China TMT Fund I, L.P.[3]	Beneficial interest	2,438,349,780	14.40%
Apoletto Managers Limited[7]	Interest in controlled corporations	1,449,637,550	8.56%
Cardew Services Limited[7]	Interest in controlled corporations	1,449,637,550	8.56%
Galileo (PTC) Limited[7]	Trustee	1,449,637,550	8.56%

Notes:

(1) The calculation is based on the total number of relevant class of Shares in issue as of December 31, 2018.

(2) Smart Mobile Holdings Limited and Smart Player Limited are both wholly-owned by Sunrise Vision Holdings Limited which is in turn wholly-owned by Parkway Global Holdings Limited. The entire interests in Parkway Global Holdings Limited is held by ARK Trust (Hong Kong) Limited as trustee for a trust established by Lei Jun (as settlor) for the benefit of Lei Jun and his family. Accordingly, ARK Trust (Hong Kong) Limited is deemed to be interested in 1) the 4,295,187,720 Class A Shares and the 2,223,884,750 Class B Shares held by Smart Mobile Holdings Limited; and 2) the 59,221,630 Class B Shares held by Smart Player Limited under the SFO.

ARK Trust (Hong Kong) Limited is also a trustee for a number of trusts and therefore is deemed to be interested in the 775,841,387 Class B shares held by the trusts.

(3) TMT General Partner Ltd. controls Morningside China TMT GP, L.P. and Morningside China TMT GP II, L.P. which respectively control Morningside China TMT Fund I, L.P., which holds 2,438,349,780 Class B Shares, and Morningside China TMT Fund II, L.P, which holds 409,475,770 Class B Shares. Consequently, TMT General Partner Ltd. is deemed to be interested in the Shares in which the Morningside Funds have an interest.

(4) Each of Liu Qin (our non-executive Director), Shi Jianming and Morningside Venture (VII) Investments Limited is entitled to exercise or control the exercise of one-third of the voting power at general meetings of TMT General Partner Ltd. and is therefore deemed to be interested in the Shares in which TMT General Partner Ltd. is interested. Morningside Ventures Limited is indirectly 100% held through a series of 100% owned holding companies by Landmark Trust Switzerland SA as trustee of a discretionary trust established by Mdm. Chan Tan Ching Fen for the benefit of certain members of her family and other charitable objects. None of the discretionary objects of this trust are Directors.

(5) Lou Yiting is deemed to be interested in these Shares through the interest of her spouse, Shi Jianming.

(6) Ni Yuanyuan is deemed to be interested in these Shares through the interest of her spouse, Liu Qin (non-executive Director). The interests of Liu Qin is disclosed in the above section headed "Directors' Interests and Short Positions in Shares and Underlying Shares and Debentures of the Company or any of its Associated Corporations".

(7) Apoletto China I, L.P. (holds 366,382,680 Class B Shares), Apoletto China II, L.P. (holds 378,595,440 Class B Shares), Apoletto China III, L.P. (holds 255,417,400 Class B Shares), Apoletto China IV, L.P. (holds 425,033,880 Class B Shares), and Apoletto Investments II, L.P. (holds 24,208,150 Class B Shares), are funds managed by Apoletto Mangers Limited, which is wholly-owned by Cardew Services Limited. Cardew Services Limited is held by Galileo (PTC) Limited as trustee for Cassiopeia Trust.

Save as disclosed above, as of December 31, 2018, no person, other than the Directors whose interests are set out in the section headed "Directors' Interests and Short Positions in Shares and Underlying Shares and Debentures of the Company or any of its Associated Corporations" above, had any interests or short positions in the Shares or underlying Shares as recorded in the register required to be kept pursuant to Section 336 of the SFO.

Contracts with Controlling Shareholders

No contract of significance has been entered into among the Company or any of its subsidiaries and the Controlling Shareholders during the year ended December 31, 2018.

Management Contracts

No contract, concerning the management and administration of the whole or any substantial part of the business of the Company was entered into or existed during the year ended December 31, 2018.

Connected Transactions

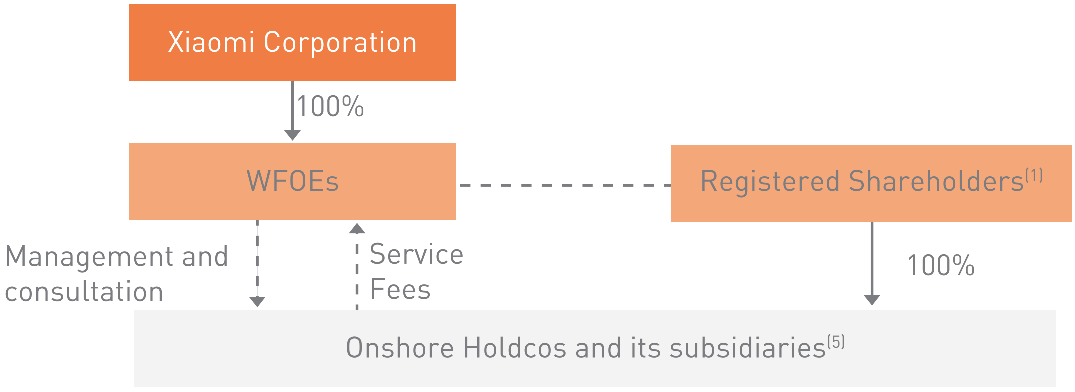
We have entered into a number of continuing agreements and arrangements with our connected persons in our ordinary and usual course of business, which constitute continuing connected transactions under the Listing Rules. We set out below details of the continuing connected transactions for our Group, in compliance with the requirements of Chapter 14A of the Listing Rules.

1. Contractual Arrangements

Contractual Arrangements in Place

The Company has entered into a series of Contractual Arrangements with the Consolidated Affiliated Entities and the Registered Shareholders, pursuant to which our Company obtained effective control over and had the right to receive all economic benefits from the business and operations of the Consolidated Affiliated Entities. In this regard, our Directors consider that our Company can consolidate the financial results of our Consolidated Affiliated Entities into our Group's financial information as if they were our Company's subsidiaries.

The following simplified diagram illustrates the Contractual Arrangements that were in place as of December 31, 2018:



DIRECTOR'S REPORT

Notes:

(1) Registered Shareholders refer to the registered shareholders of the Onshore Holdcos, namely (i) Beijing Wali Culture; (ii) Rigo Design; (iii) Xiaomi Inc.; (iv) Beijing Duokan; (v) Beijing Wali Internet; (vi) Xiaomi Pictures; (vii) Beijing Electronic Software; and (viii) Youpin Information Technology.

(i) Beijing Wali Culture is owned by Lei Jun (雷軍) as to 90% and Shang Jin (尚進) as to 10%.

(ii) Rigo Design is owned by Zhu Yin (朱印) as to 61% and Li Jiong (李炯) as to 39%.

(iii) Xiaomi Inc. is owned by Lei Jun as to 77.80%, Li Wanqiang (黎萬强) as to 10.12%, Hong Feng (洪鋒) as to 10.07% and Liu De (劉德) as to 2.01%.

(iv) Beijing Duokan is owned by Wang Chuan (王川) as to 61.75% and Lei Jun as to 38.25%.

(v) Beijing Wali Internet is owned by Lei Jun as to 10%, Liu Yang (劉泱) as to 65%, Liang Qiushi (梁秋實) as to 14%, Liu Jingyan (劉景岩) as to 6%, Yuan Bin (袁彬) as to 3%, and Nan Nan (南楠) as to 2%.

(vi) Xiaomi Pictures is owned by Li Wanqiang as to 87.92%, Hong Feng as to 10.07% and Liu De as to 2.01%.

(vii) Beijing Electronic Software is owned by Lei Jun (雷軍) as to 90% and Hong Feng (洪鋒) as to 10%.

(viii) Youpin Information Technology is owned by Lei Jun (雷軍) as to 70%, Hong Feng (洪鋒) as to 10%, Liu De (劉德) as to 10% and Li Wanqiang (黎萬强) as to 10%.

(2) "→" denotes direct legal and beneficial ownership in the equity interest.

(3) "---->" denotes contractual relationship.

(4) "----"denotes the control by WFOEs over the Registered Shareholders and the Onshore Holdcos through (i) powers of attorney to exercise all shareholders' rights in the Onshore Holdcos, (ii) exclusive options to acquire all or part of the equity interests in the Onshore Holdcos and (iii) equity pledges over the equity interests in the Onshore Holdcos.

(5) These include certain companies which do not currently carry out any business operations but are intended to carry out businesses which are subject to foreign investment restrictions in accordance with the Guidance Catalog of Industries for Foreign Investment.

A brief description of each of the specific agreements that comprise the Contractual Arrangements entered into by each of the WFOEs and the Onshore Holdcos is set out as follows:

a) Exclusive Business Cooperation Agreements

Under the exclusive business cooperation agreements dated December 1, 2017, April 11, 2018, April 17, 2018 and June 4, 2018, respectively, between the Onshore Holdcos and the WFOEs (the "**Exclusive Business Cooperation Agreements**"), pursuant to which, in exchange for a monthly service fee, the Onshore Holdcos agreed to engage the WFOEs as its exclusive provider of technical support, consultation and other services, including the following services:

(i) the use of any relevant software legally owned by the WFOEs;

(ii) development, maintenance and updating of software in respect of the Onshore Holdcos' business;

(iii) design, installation, daily management, maintenance and updating of network systems, hardware and database design;

(iv) providing technical support and staff training services to relevant employers of the Onshore Holdcos;

(v) providing assistance in consultancy, collection and research of technology and market information (excluding market research business that wholly foreign owned enterprises are prohibited from conducting under the laws of mainland China);

(vi) providing business management consultation;

(vii) providing marketing and promotional services;

(viii) providing customer order management and customer services;

(ix) transfer, leasing and disposal of equipment or properties; and

(x) other relevant services requested by the Onshore Holdcos from time to time to the extent permitted under the laws of mainland China.

Under the Exclusive Business Cooperation Agreements, the service fee shall consist of 100% of the total consolidated profit of the Onshore Holdcos, after the deduction of any accumulated deficit of the Consolidated Affiliated Entities in respect of the preceding financial year(s), operating costs, expenses, taxes and other statutory contributions and subject to any necessary adjustment by the WFOEs of the scope and amount of service fees according to the PRC tax law and practices.

DIRECTOR'S REPORT

b) Exclusive Option Agreements

Under the exclusive option agreements dated December 1, 2017, April 11, 2018, April 17, 2018 and June 4, 2018, respectively, among the Onshore Holdcos, the WFOEs and the Registered Shareholders (the "**Exclusive Option Agreements**"), pursuant to which the WFOEs have the rights to require the Registered Shareholders to transfer any or all their equity interests in the Onshore Holdcos to the WFOEs and/or a third party designated by it, in whole or in part at any time and from time to time, for considerations equivalent to the respectively outstanding loans owed to the Registered Shareholders (or part of the loan amounts in proportion to the equity interests being transferred) or, if applicable, for a nominal price, unless the relevant government authorities or the PRC laws request that another amount be used as the purchase price, in which case the purchase price shall be the lowest amount under such request. The Exclusive Option Agreements shall remain effective unless terminated in the event that the entire equity interests held by the Registered Shareholders in the Onshore Holdcos have been transferred to the WFOEs or their appointee(s).

c) Equity Pledge Agreements

Under the equity pledge agreements dated December 1, 2017, April 11, 2018, April 17, 2018 and June 4, 2018, respectively, entered into between the WFOEs, the Registered Shareholders and the Onshore Holdcos, pursuant to which the Registered Shareholders agreed to pledge all their respective equity interests in the Onshore Holdcos that they own, including any interest or dividend paid for the shares, to the WFOEs as a security interest to guarantee the performance of contractual obligations and the payment of outstanding debts. The pledge in respect of the Onshore Holdcos takes effect upon the completion of registration with the relevant administration for industry and commerce and shall remain valid until after all the contractual obligations of the Registered Shareholders and the Onshore Holdcos under the relevant Contractual Arrangements have been fully performed and all the outstanding debts of the Registered Shareholders and the Onshore Holdcos under the relevant Contractual Arrangements have been fully paid.

d) Powers of attorney

The Registered Shareholders executed powers of attorney on December 1, 2017, April 11, 2018, April 17, 2018 and June 4, 2018, respectively, (the "**Powers of Attorney**") pursuant to which the Registered Shareholders irrevocably appointed the WFOEs and their designated persons (including but not limited to Directors and their successors and liquidators replacing the Directors but excluding those non-independent or who may give rise to conflict of interests) as their attorneys-in-fact to exercise on their behalf, and agreed and undertook not to exercise without such attorneys-in-fact's prior written consent, any and all right that they have in respect of their equity interests in the Onshore Holdcos. The Powers of Attorney shall remain effective for so long as each shareholder holds equity interest in the Onshore Holdco.

e) Loan Agreements

In relation to Beijing Wali Culture, Xiaomi Inc., Beijing Electronic Software and Youpin Information Technology only, the relevant WFOEs and their Registered Shareholders entered into loan agreements dated December 1, 2017, April 11, 2018, April 17, 2018 and June 4, 2018, respectively, pursuant to which the relevant WFOEs agreed to provide loans to the Registered Shareholders, to be used exclusively as investment in the relevant Onshore Holdcos. The term of each loan commences from the date of the agreement and ends on the date the lender exercises its exclusive call option under the relevant exclusive option agreement, or when certain defined termination events occur, such as if the lender sends a written notice demanding repayment to the borrower, or upon the default of the borrower, whichever is earlier.

Save as disclosed above, there were no other new contractual arrangements entered into, renewed and/or reproduced between our Group and our Onshore Holdcos and/or Consolidated Affiliated Entities during the year ended December 31, 2018. There was no material change in the Contractual Arrangements and/or the circumstances under which they were adopted during the year ended December 31, 2018.

For the year ended December 31, 2018, none of the Contractual Arrangements had been unwound on the basis that none of the restrictions that led to the adoption of the Contractual Arrangements had been removed. As of December 31, 2018, we had not encountered interference or encumbrance from any PRC governing bodies in operating our businesses through our Consolidated Affiliated Entities under the Contractual Arrangements.

The revenue of the Consolidated Affiliated Entities amounted to RMB4,412 million for the year ended December 31, 2018, representing an increase by 4.0% from RMB4,240 million for the year ended December 31, 2017. For the year ended December 31, 2018, the revenue of the Consolidated Affiliated Entities accounted for approximately 2.5% of the revenue of our Group (2017: 3.7%).

Reasons for Adopting the Contractual Arrangements

Our (i) operation of online culture business; (ii) Internet audio-visual program service; (iii) Internet publication business and (iv) news business conducted by our Consolidated Affiliated Entities are considered as "prohibited" under the Guidance Catalog of Industries for Foreign Investment (the "**Catalog**") where foreign investment is strictly prohibited (collectively, the "**Prohibited Business**"). Our (i) e-commerce marketplace business; (ii) cloud storage service and other value-added telecommunication service business; and (iii) resales of mobile communication products operated by our Consolidated Affiliated Entities are considered as "restricted" under the Catalog where foreign investors are restricted from holding more than 50% equity interests in companies providing such services or shall meet certain qualification requirements (collectively, the "**Restricted Business**", together with the Prohibited Business, the "**Relevant Businesses**"). For details of the foreign investment restrictions relating to the Contractual Arrangements, please refer to the sections headed "Contractual Arrangements — Qualification Requirements

DIRECTOR'S REPORT

under the FITE Regulations" and "Contractual Arrangements — Development in Legislation on Foreign Investment in Mainland China" on pages 281 to 282 and pages 293 to 298 of the Prospectus. Since investment in the Relevant Businesses in which we currently and may operate are subject to restrictions under current mainland China laws and regulations, as advised by our PRC legal adviser, we determined that it was not viable for our Company to hold our Consolidated Affiliated Entities directly through equity ownership. Instead, we decided that, in line with common practice in industries in mainland China subject to foreign investment restrictions, we would gain effective control over, and have the right to receive all the economic benefits generated by the Relevant Businesses currently operated by our Consolidated Affiliated Entities through the Contractual Arrangements between the WFOEs, on the one hand, and our Consolidated Affiliated Entities and the Registered Shareholders, on the other hand.

Our Directors believe that the Contractual Arrangements are fair and reasonable because: (i) the Contractual Arrangements were freely negotiated and entered into between the WFOEs and our Consolidated Affiliated Entities and the Registered Shareholders; (ii) by entering into the exclusive business cooperation agreements with the WFOEs, which are mainland China subsidiaries of our Company, our Consolidated Affiliated Entities will enjoy better economic and technical support from us, as well as a better market reputation after the Listing, and (iii) a number of other companies use similar arrangements to accomplish the same purpose.

Risks relating to the Contractual Arrangements

The Company believes the following risks are associated with the Contractual Arrangements, including:

- the PRC government may find that the agreements that establish the structure for operating our business do not comply with PRC laws and regulations, which may subject us to severe penalties or be forced to relinquish our interests in those operations;
- substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of Foreign Investment Law of the People's Republic of China (中華人民共和國外商投資法) and how it may impact the viability of our current corporate structure, corporate governance and business operations;
- the Contractual Arrangements may not be as effective in providing operational control as direct ownership and our Consolidated Affiliated Entities and the Registered Shareholders may fail to perform their obligations under the Contractual Arrangements;
- we may lose the ability to use, or otherwise benefit from, the licenses, approvals and assets held by our Consolidated Affiliated Entities, which could render us unable to conduct some or all of our business operations and constrain our growth;

- the Contractual Arrangements may be subject to scrutiny by the PRC tax authorities and any additional taxes could substantially reduce our consolidated profit and value of your investment;

- the equity holders, directors and executive officers of the Consolidated Affiliated Entities, as well as our employees who execute other strategic initiatives, may have potential conflicts of interest with our Company;

- certain of the terms of the Contractual Arrangements may not be enforceable under the PRC laws and regulations; and

- our exercise of the option to acquire equity ownership of our Consolidated Affiliated Entities may subject us to certain limitations and substantial costs.

Further details of these risks are set out in the section headed "Risk Factors — Risks Relating to Our Contractual Arrangement" on pages 86 to 93 of the Prospectus.

Our Group has adopted the following measures to ensure the effective operation of our Group with the implementation of the Contractual Arrangements and our compliance with the Contractual Arrangements:

- major issues arising from the implementation and compliance with the Contractual Arrangements or any regulatory enquiries from government authorities, where necessary, have been submitted to our Board, if necessary, for review and discussion on an occurrence basis;

- our Board has reviewed the overall performance of and compliance with the Contractual Arrangements for the year ended December 31, 2018;

- our Company has disclosed the overall performance and compliance with the Contractual Arrangements in our annual reports; and

- our Company has engaged external legal advisors or other professional advisors, if necessary, to assist the Board to review the implementation of the Contractual Arrangements, review the legal compliance of WFOE and our Consolidated Affiliated Entities to deal with specific issues and matters arising from the Contractual Arrangements.

DIRECTOR'S REPORT

Requirement related to Contractual Arrangements (other than relevant foreign ownership restrictions) as of December 31, 2018

On December 11, 2001, the State Council promulgated the Regulations for the Administration of Foreign-Invested Telecommunications Enterprises (the "**FITE Regulations**"), which were amended on September 10, 2008 and February 6, 2016. According to the FITE Regulations, foreign investors are not allowed to hold more than 50% of the equity interests in a company providing value-added telecommunications services, including provision of internet content services. In addition, a foreign investor who invests in a value-added telecommunications business in the PRC must possess prior experience in operating value-added telecommunications businesses and a proven track record of business operations overseas (the "**Qualification Requirements**"). Currently none of the applicable PRC laws, regulations or rules provides clear guidance or interpretation on the Qualification Requirements. According to our consultation with the Ministry of Industry and Information Technology (the "**MIIT**") in March 2018, it confirms that there is no clear guidance about how a foreign investor could meet the Qualification Requirements, and it applies a relatively strict standard for identifying whether foreign investors meet the Qualification Requirements.

Despite the lack of clear guidance or interpretation on the Qualification Requirements, we have been gradually building up our track record of overseas telecommunications business operations for the purposes of being qualified, as early as possible, to acquire the entire equity interests in Onshore Holdcos or any of our Consolidated Affiliated Entities when the relevant PRC laws allow foreign investors to invest and to hold any equity interest in enterprises which engage in the value-added telecommunications enterprises in China. For the purposes of meeting the Qualification Requirements, we are in the process of establishing and accumulating overseas operation experience, for example:

- we have incorporated a number of overseas entities for the purpose of expanding our businesses overseas;

- Xiaomi Inc. has entered into an agreement with a third party in relation to the operation and management of the domain name www.mi.com/in/ for the purpose of promoting and selling our products and services in India; and

- we have registered a number of domain names overseas for the purpose of promoting our products and services.

In our consultation with the MIIT, the MIIT also confirmed that the above steps taken by us may be deemed to satisfy the Qualification Requirements if we follow the above steps continuously for a period of time and have accumulated the experience in providing the value-added telecommunications services in overseas markets, which is in accordance with the FITE Regulations.

Listing Rules Implications and Waivers from the Stock Exchange

For the purposes of Chapter 14A of the Listing Rules, and in particular the definition of "connected person," the Consolidated Affiliated Entities will be treated as our Company's wholly-owned subsidiaries, and their directors, chief executives or substantial shareholders (as defined in the Listing Rules) and their respective associates will be treated as our Company's "connected persons". Therefore, the transactions contemplated under the Contractual Arrangements constitute continuing connected transactions of our Company.

In view of the Contractual Arrangements, we have applied to the Stock Exchange for, and the Stock Exchange has granted, a waiver from strict compliance with (i) the announcement, circular and independent shareholders' approval requirements under Chapter 14A of the Listing Rules in respect of the transactions contemplated under the Contractual Arrangements pursuant to Rule 14A.105 of the Listing Rules, (ii) the requirement of setting an annual cap for the transactions under the Contractual Arrangements under Rule 14A.53 of the Listing Rules, and (iii) the requirement of limiting the term of the Contractual Arrangements to three years or less under Rule 14A.52 of the Listing Rules, for so long as our Shares are listed on the Stock Exchange subject however to the following conditions:

(a) no change to the Contractual Arrangements without independent non-executive Directors' approval;

(b) no change to the agreements governing the Contractual Arrangements without independent Shareholders' approval;

(c) the Contractual Arrangements shall continue to enable our Group to receive the economic benefits derived by the Consolidated Affiliated Entities;

(d) the Contractual Arrangements may be renewed and/ or reproduced without obtaining the approval of our Shareholders: (i) upon the expiry of the existing arrangements, (ii) in connections with any changes to the Registered Shareholders or directors of the Consolidated Affiliated Entities, or (iii) in relation to any existing, newly established or acquired wholly foreign-owned enterprise or operating company (including branch company), engaging in a business similar or relating to those of our Group when such renewal and/or reproduction is justified by business expediency and on substantially the same terms and conditions as the existing Contractual Arrangements; and

(e) we will disclose details relating to the Contractual Arrangements on an on-going basis.

Confirmation from Independent Non-executive Directors

The Company's independent non-executive Directors have reviewed the Contractual Arrangements and confirmed that:

(i) the transactions carried out during the year ended December 31, 2018 have been entered into in accordance with the relevant provisions of the Contractual Arrangements;

DIRECTOR'S REPORT

(ii) no dividends or other distributions have been made by the Consolidated Affiliated Entities to the holders of its equity interests which are not otherwise subsequently assigned or transferred to the Group during the year ended December 31, 2018; and

(iii) any new contracts entered into, renewed or reproduced between the Group and the Consolidated Affiliated Entities during the year ended December 31, 2018 are fair and reasonable, or advantageous to the Shareholders, so far as the Group is concerned and in the interests of the Shareholders as a whole.

Confirmations from the Company's Independent Auditor

The Auditor has confirmed in a letter to the Board that, with respect to the aforesaid Contractual Arrangements:

(i) nothing has come to their attention that causes the Auditor to believe that the disclosed transactions under the Contractual Arrangements have not been approved by the Board;

(ii) nothing has come to their attention that causes the Auditor to believe that the transactions were not entered into, in all material respects, in accordance with the relevant agreements under the Contractual Arrangements governing such transactions; and

(iii) no dividends or other distributions had been made by our Consolidated Affiliated Entities to the holders of their equity interests which were not otherwise subsequently assigned or transferred to our Group.

2. Other Connected Transactions

As disclosed in the Prospectus, the following transactions of the Group constituted continuing connected transactions for the Company for the year ended December 31, 2018.

(1) The XMF Framework Agreement

On June 18, 2018, our Company (for itself and on behalf of our Group) and Xiaomi Finance Inc. ("**Xiaomi Finance**", together with its subsidiaries from time to time, the "**Xiaomi Finance Group**") (for itself and on behalf of the Xiaomi Finance Group) entered into a framework agreement (the "**XMF Framework Agreement**"), pursuant to which our Group (other than the Xiaomi Finance Group) ("**XM Group**") and the Xiaomi Finance Group shall provide to each other or by one to the other, (i) supply of products; (ii) data sharing and collaboration; (iii) intellectual property licensing; (iv) payment and settlement services; (v) marketing services; (vi) comprehensive support services; and (vii) financial services. Such arrangements have significant strategic advantages to our Group as a whole, particularly in terms of resources optimization and allocation, and the efficiency of intra-group coordination may also achieve considerable cost-savings to our Group as a whole.

Among all the transactions under the XMF Framework Agreement, (i) data sharing and collaboration; (ii) intellectual property licensing; (iii) provision of marketing services by the Xiaomi Finance Group to XM Group; (iv) provision of comprehensive support services by the Xiaomi Finance Group to XM Group and (v) provision of financial services by the Xiaomi Finance Group to XM Group are fully-exempted continuing connected transactions under Chapter 14A of the Listing Rules.

The annual cap and actual transaction amounts for the non-exempted continuing connected transactions under the XMF Framework Agreement for the year ended December 31, 2018 are set out as follows:

No.	Transactions	Annual cap for the year ended December 31, 2018 (RMB million)	Actual transaction amounts for the year ended December 31, 2018 (RMB million)
1.	Supply of products by XM Group to the Xiaomi Finance Group	**173**	**4**
2.	Provision of payment and settlement services by the Xiaomi Finance Group to XM Group	**170**	**32**
3.	Provision of marketing services by XM Group to the Xiaomi Finance Group	**339**	**78**
4.	Provision of comprehensive support services by XM Group to the Xiaomi Finance Group	**133**	**63**
5.	Provision of financial services by XM Group to the Xiaomi Finance Group (excluding the XMF Restructuring Loans)	**12,770**	**9,022**

The XMF Framework Agreement is for a term of three years from January 1, 2018 to December 31, 2020 (both days inclusive).

We have agreed to treat members of the Xiaomi Finance Group as connected subsidiaries (as defined in Rule 14A.16 of the Listing Rules) and thus the intra-group transactions involving XM Group and the Xiaomi Finance Group under the XMF Framework Agreement will constitute connected transactions under the Listing Rules.

DIRECTOR'S REPORT

(2) **The SmartMi Framework Agreement**

On June 18, 2018, our Company (for itself and on behalf of our Group) and SmartMi International Ltd ("**SmartMi**", together with its subsidiaries from time to time, the "**SmartMi Group**") (for itself and on behalf of the SmartMi Group) entered into the SmartMi Framework Agreement, pursuant to which our Group shall purchase, and the SmartMi Group shall supply, smart hardware products such as air purifiers and humidifiers. Our Group shall sell such products through its platforms and pay a certain amount of profit derived from such sale to the SmartMi Group. Through collaboration with SmartMi, our ecosystem partner, we are able to launch a successful suite of air purifiers and related IoT devices that form an important component of our ecosystem.

The above continuing connected transaction will be for a term of three years from January 1, 2018 to December 31, 2020 (both days inclusive).

SmartMi is an associate of Koh Tuck Lye (as defined in Rule 14A.12A(1)(c) of the Listing Rules), our non-executive Director, and thus a connected person of the Company.

The annual cap for the year ended December 31, 2018 is RMB3,800 million, while the actual transaction amount for the year ended December 31, 2018 is approximately RMB2,114 million.

Confirmation from Independent Non-executive Directors

The independent non-executive Directors of the Company have reviewed the continuing connected transactions outlined above, and confirmed that such continuing connected transactions had been entered into:

(i) in the ordinary and usual course of business of our Group;

(ii) on normal commercial terms or better; and

(iii) in accordance with the relevant agreements governing them on terms that were fair and reasonable and in the interests of our Company and our Shareholders as a whole.

Confirmations from the Company's Independent Auditor

The Auditor has performed the relevant procedures regarding the Continuing Connected Transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by Hong Kong Institute of Certified Public

Accountants. The Auditor has issued an unqualified letter containing findings and conclusions in respect of the continuing connected transactions disclosed by the Group in the paragraph above in accordance with Rule 14A.56 of the Listing Rules. A copy of the Auditor's letter has been provided by the Company to the Stock Exchange.

The Auditor has confirmed in a letter to the Board that, with respect to the aforesaid continuing connected transactions entered into in the year ended December 31, 2018:

(i) nothing has come to the Auditor's attention that causes the Auditor to believe that the disclosed continuing connected transactions have not been approved by the Board;

(ii) for transactions involving the provision of goods or services by the Group, nothing has come to the Auditor's attention that causes the Auditor to believe that the continuing connected transactions were not, in all material respects, in accordance with the pricing policies of the Group; and

(iii) nothing has come to the Auditor's attention that causes the Auditor to believe that the transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions;

(iv) nothing has come to the Auditor's attention that causes the Auditor to believe that such continuing connected transactions have exceeded the annual caps as set by the Company.

Save as disclosed in this annual report, during the year ended December 31, 2018, the Company had no connected transactions or continuing connected transactions which are required to be disclosed under the Listing Rules. The Company has complied with the disclosure requirements under Chapter 14A of the Listing Rules with respect to the continuing connected transactions entered into by the Group during the year ended December 31, 2018.

Major Customers and Suppliers

For the year ended December 31, 2018, the five largest customers of the Group accounted for approximately 26.4% of the Group's total revenues while the largest customer of the Group accounted for approximately 10.9% of the Group's total revenues. In addition, for the year ended December 31, 2018, the five largest suppliers of the Group accounted for approximately 40.0% of the Group's total purchase amounts while the largest supplier for the years ended December 31, 2018 accounted for approximately 12.1% of our total purchase amount.

None of our Directors, their respective associates, or any Shareholder who, to the knowledge of our Directors, owns more than 5% of our issued capital, has any interest in any of our five largest customers and suppliers during the year ended December 31, 2018 and up to the date of this annual report.

DIRECTOR'S REPORT

Employee and Remuneration Policies

As of December 31, 2018, we had 16,683 full-time employees, 15,686 of whom were based in mainland China, primarily at our headquarters in Beijing, with the rest primarily based in India and Indonesia. We expect to continue to increase our headcount in mainland China and our key target global markets. As of December 31, 2018, our research and development personnel, totaling 7,371 employees, were staffed across our various departments.

Our success depends on our ability to attract, retain and motivate qualified personnel. As part of our human resources strategy, we offer employees competitive compensation packages. As of December 31, 2018, 5,966 employees held share-based awards. The total remuneration expenses, including share-based compensation expense, for the year ended December 31, 2018 were RMB17,114.9 million, representing an increase of 322.6% from the year ended December 31, 2017 of RMB4,050.1 million, primarily due to a one-off share-based compensation in the second quarter of 2018.

Pre-Emptive Rights

There are no provisions for pre-emptive rights under the Articles of Association or the laws of the Cayman Islands which would oblige the Company to offer new Shares on a pro-rata basis to the existing Shareholders.

Weighted Voting Rights

The Company is controlled through weighted voting rights. Each Class A Share has 10 votes per share and each Class B Share has one vote per share except with respect to resolutions regarding a limited number of Reserved Matters, where each Share has one vote. The Company's weighted voting rights structure will enable the WVR Beneficiaries to exercise voting control over the Company notwithstanding the WVR Beneficiaries do not hold a majority economic interest in the share capital of the Company. This allows the Company to benefit from the continuing vision and leadership of the WVR Beneficiaries who will control the Company with a view to its long-term prospects and strategy.

Shareholders and prospective investors are advised to be aware of the potential risks of investing in companies with weighted voting rights structures, in particular that interests of the WVR Beneficiaries may not necessarily always be aligned with those of our Shareholders as a whole, and that the WVR Beneficiaries will be in a position to exert significant influence over the affairs of the Company and the outcome of shareholders' resolutions, irrespective of how other shareholders vote. Prospective investors should make the decision to invest in the Company only after due and careful consideration.

As of December 31, 2018, the WVR Beneficiaries were Lei Jun and Lin Bin. Lei Jun beneficially owns 4,295,187,720 Class A Shares, representing approximately 51.2% of the voting rights in the Company with respect to shareholder resolutions relating to matters other than the Reserved Matters. The Class A Shares are held by Smart Mobile Holdings Limited, a company indirectly wholly-owned by a trust established by Lei Jun (as settlor) for the benefit of Lei Jun and his family. Lin Bin beneficially owns 2,400,000,000 Class A Shares, representing 28.6% of the voting rights in the Company with respect to shareholder resolutions relating to matters other than the Reserved Matters. The Class A Shares are held on behalf of Lin Bin and his family members by Lin Bin as trustee of the Bin Lin Trust.

Class A Shares may be converted into Class B Shares on a one to one ratio. As of December 31, 2018, upon the conversion of all the issued and outstanding Class A Shares into Class B Shares, the Company will issue 6,695,187,720 Class B Shares, representing 39.54% of the total number of issued and outstanding Class B Shares or 28.34% of the issued share capital of the Company.

The weighted voting rights attached to Class A Shares will cease when none of the WVR Beneficiaries have beneficial ownership of any of the Class A Shares, in accordance with Rule 8A.22 of the Listing Rules. This may occur:

(i) upon the occurrence of any of the circumstances set out in Rule 8A.17 of the Listing Rules, in particular where the WVR Beneficiary is: (1) deceased; (2) no longer a member of the Board; (3) deemed by the Stock Exchange to be incapacitated for the purpose of performing his duties as a director; or (4) deemed by the Stock Exchange to no longer meet the requirements of a director set out in the Listing Rules;

(ii) when the Class A Shareholders have transferred to another person the beneficial ownership of, or economic interest in, all of the Class A Shares or the voting rights attached to them, other than in the circumstances permitted by Rule 8A.18 of the Listing Rules;

(iii) where a vehicle holding the Class A Shares on behalf of a WVR Beneficiary no longer complies with Rule 8A.18(2) of the Listing Rules; or

(iv) when all of the Class A Shares have been converted to Class B Shares.

Corporate Governance

The Company is committed to maintaining and promoting stringent corporate governance standards. The principles of the Company's corporate governance are to promote effective internal control measures and to enhance the transparency and accountability of the Board to all the Shareholders.

Information on the corporate governance practices adopted by the Company is set out in the Corporate Governance Report on pages 100 to 116 of this annual report.

DIRECTOR'S REPORT

Environmental Policies and Performance

The Company attaches great importance to environmental protection and resource conservation, and continuously pays attention to the impact of its business operations on the environment. The Company advocates the concept of green office and green product by incorporating it into the product life cycle, while focusing on improving the performance of resource utilization and emission management. At the same time, as a core element in the value chain, the Company hopes to work with more peers to create a green value chain.

For details of the Company's environmental policies and performance, please refer to the Environmental, Social and Governance Report on pages 117 to 162 of this annual report.

Final Dividend

The Board has resolved not to declare any final dividend for the year ended December 31, 2018.

Use of Net Proceeds from Listing

With the shares of the Company listed on the Stock Exchange on July 9, 2018, the net proceeds received by the Company from the Global Offering (as defined in the Prospectus) were approximately HK$27,561.0 million. There was no change in the intended use of net proceeds as previously disclosed in the Prospectus.

As of December 31, 2018, the Group had utilized the net proceeds as set out in the table below,

	Net proceeds from Global Offering (HK$ million)	Utilization for the year ended December 31, 2018 (HK$ million)	Unutilized amount (HK$ million)
Research and development to develop core in-house products	8,268.3	2,193.6	6,074.7
Investments to expand and strengthen ecosystem	8,268.3	428.3	7,840.0
Global expansion	8,268.3	6,944.8	1,323.5
Working capital and other general corporate purposes	2,756.1	2,756.1	—

Audit Committee

The Company has established the Audit Committee in compliance with Rule 3.21 of the Listing Rules and the CG Code. The primary duties of the Audit Committee are to review and supervise the financial reporting process and internal controls system of the Group, review and approve connected transactions and to advise the Board. The Audit Committee comprises one non-executive Director and two independent non-executive Directors, namely, Dr. Chen Dongsheng, Mr. Koh Tuck Lye and Mr. Wong Shun Tak. Mr. Wong Shun Tak is the chairman of the Audit Committee.

The Audit Committee has reviewed the audited consolidated financial statements of the Group for the year ended December 31, 2018. The Audit Committee has also discussed matters with respect to the accounting policies and practices adopted by the Company and internal control with senior management members and the Auditor.

Material Litigation

The Company was not involved in any material litigation or arbitration during the year ended December 31, 2018. Nor were the Directors aware of any material litigation or claims that were pending or threatened against the Company.

Public Float

Based on the information that is publicly available to the Company and within the knowledge of the Directors as of December 31, 2018, the Company has maintained the prescribed percentage of public float under the Listing Rules.

Compliance with Relevant Laws and Regulations

As far as the Board is aware, the Group has complied with the relevant laws and regulations that have a significant impact on the Group in all material aspects.

Auditor

The consolidated financial statements of the Group have been audited by PricewaterhouseCoopers, who will retire and, being eligible, offer themselves for re-appointment at the annual general meeting.

Events After the Report Period

Save as disclosed in this annual report, there was no other significant event that might affect the Group since December 31, 2018.

CORPORATE GOVERNANCE REPORT

Corporate Governance Practices

The Company is committed to maintaining and promoting stringent corporate governance standards. The principles of the Company's corporate governance are to promote effective internal control measures and to enhance the transparency and accountability of the Board to all the Shareholders.

The Company was incorporated in the Cayman Islands on January 5, 2010 with limited liability, and the Class B Shares were listed on the Main Board of the Stock Exchange on July 9, 2018 (i.e. the Listing Date). The Company has applied the principles and code provisions of the CG Code contained in Appendix 14 to the Listing Rules as the basis of the Company's corporate governance practices since the Listing Date.

The Board will continue to enhance its corporate governance practices appropriate to the conduct and growth of its business and to review such practices from time to time to ensure that they comply with statutory and professional standards and align with the latest development.

Save for code provision A.2.1 of the CG Code, the Company has complied with all the code provisions set out in the CG Code throughout the period from the Listing Date to December 31, 2018 (the "**Report Period**"). Key corporate governance principles and practices of the Company as well as details relating to the foregoing deviation are summarized below.

Compliance with the Model Code for Securities Transactions by Directors

The Company has adopted the Model Code as the code of conduct regarding the Directors' dealings in the securities of the Company. Having made specific enquiry of all the Directors, all Directors confirmed that they have complied with the provisions of the Model Code throughout the Report Period.

Board of Directors

Board Composition

The Board currently comprises the following Directors:

Executive Directors
Lei Jun *(Chairman and Chief Executive Officer)*
Lin Bin *(President)*

Non-executive Directors:
Koh Tuck Lye
Liu Qin

Independent Non-executive Directors:
Chen Dongsheng
Lee Ka Kit
Wong Shun Tak

The biographical information of the Directors are set out in the section headed "Biographical Details and Other Information of the Directors" in this annual report.

Throughout the Report Period, the Board has met the requirements of the Listing Rules regarding the appointment of at least three independent non-executive directors (representing at least one-third of the Board), with at least one of whom possessing appropriate professional qualifications, or accounting, or related financial management expertise.

The Company has received written annual confirmation from each of the independent non-executive Director in respect of his independence in accordance with the independence guidelines set out in Rule 3.13 of the Listing Rules. The Company is of the view that all independent non-executive directors are independent.

Responsibilities and Delegation

The Board should assume responsibility for leadership and control of the Company, be responsible for directing and supervising the Company's affairs and act in the best interests of the Company and its shareholders.

The Board directly, and indirectly through its committees, leads and provides direction to management by laying down strategies and overseeing their implementation, monitors the Group's operational and financial performance, and ensures that sound internal control and risk management systems are in place.

All Directors, including non-executive Directors and independent non-executive Directors, have brought a wide spectrum of valuable business experience, knowledge and professionalism to the Board for its efficient and effective functioning. All Directors have full and timely access to all the information of the Company, and may upon request, seek independent professional advice in appropriate circumstances at the Company's expenses for discharging their duties to the Company. The Directors shall disclose to the Company details of other offices held by them.

CORPORATE GOVERNANCE REPORT

The Board reserves for its decision on all major matters relating to policy matters, strategies and budgets, internal control and risk management, material transactions (in particular those that may involve conflict of interests), financial information, appointment of directors and other significant operational matters of the Company. Responsibilities relating to implementing decisions of the Board, directing and coordinating the daily operation and management of the Company are delegated to the chief executive officer and management. The delegated functions and responsibilities are periodically reviewed by the Board. Approval has to be obtained from the Board prior to any significant transactions entered into by the aforesaid officers.

Chairman and Chief Executive Officer

Pursuant to code provision A.2.1 of the CG Code, companies listed on the Stock Exchange are expected to comply with, but may choose to deviate from the requirement that the responsibilities between the chairman and the chief executive officer should be segregated and should not be performed by the same individual. The Company does not have a separate chairman and chief executive officer and Lei Jun currently performs these two roles. The Board believes that vesting the roles of both chairman and chief executive officer in the same person has the benefit of ensuring consistent leadership within the Group and enabling more effective and efficient overall strategic planning for the Group. The Board considers that the balance of power and authority for the present arrangement will not be impaired and this structure will enable the Company to make and implement decisions promptly and effectively. The Board will continue to review and consider segregating the roles of the chairman of the Board and the chief executive officer of the Company at an appropriate time, taking into account the circumstances of the Group as a whole.

Appointment and Re-Election of Directors

According to the Articles of the Company, at every annual general meeting of the Company, one-third of the Directors for the time being (or if their number is not three or a multiple of three, then the number nearest to but not less than one-third) shall retire from office by rotation provided that every Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every three years. A Director appointed by the Board or by ordinary resolutions of the Company, either to fill a casual vacancy or as an addition to the Board, shall hold office only until the next following general meeting of the Company. All retiring Directors shall be eligible for re-election.

Each Director (including the non-executive Directors and independent non-executive Directors) is engaged for a term of three years. They are subject to retirement and re-election in accordance with the provisions of the Articles as mentioned above.

Continuous Professional Development of Directors

Directors shall keep abreast of regulatory developments and changes in order to effectively perform their responsibilities and to ensure that their contribution to the Board remains informed and relevant.

Each newly appointed Director has received formal, comprehensive and tailored induction on the first occasion of his appointment to ensure appropriate understanding of the business and operations of the Company and full awareness of director's responsibilities and obligations under the Listing Rules and relevant regulatory requirements. Such induction shall be supplemented by meetings with the senior management of the Company.

Pursuant to code provision A.6.5 of the CG Code, Directors should participate in appropriate continuous professional development to develop and refresh their knowledge and skills to ensure that their contribution to the Board remains informed and relevant. Internally-facilitated briefings for Directors would be arranged and reading materials on relevant topics would be provided to Directors where appropriate. All Directors are encouraged to attend relevant training courses at the Company's expenses.

Throughout the Report Period, the Directors have participated in continuous professional training as follows:

Name of director	Type of continuous professional development training[1],[2]
Lei Jun	A & B
Lin Bin	A & B
Koh Tuck Lye	A & B
Liu Qin	A & B
Chen Dongsheng	A & B
Lee Ka Kit	A & B
Wong Shun Tak	A & B

Notes:

(1) A: Attending seminar(s), conference(s), forum(s) and/or training course(s)

(2) B: Reading materials provided by external parties or by the Company including but not limited to updates relating to the Company's business or directors' duties and responsibilities, corporate governance and regulatory update, Chapter 8A of the Listing Rules and knowledge relating to the weighted voting rights, and other applicable regulatory requirements.

CORPORATE GOVERNANCE REPORT

Attendance Records of Directors

As the Company was listed on the Stock Exchange on the Listing Date, no Nomination Committee and Remuneration Committee meeting was held during the Report Period. During the Report Period, the Company has held two Board meetings, two Audit Committee meetings and one Corporate Governance Committee meeting. The attendance records of each Director at the above Board and Board committee meetings of the Company are set out in the table below.

	Attendance/Number of Meetings		
Name of Director	Board	Audit Committee	Corporate Governance Committee
Lei Jun	2/2	—	—
Lin Bin	2/2	—	—
Koh Tuck Lye	2/2	2/2	—
Liu Qin	2/2	—	—
Chen Dongsheng	2/2	2/2	1/1
Lee Ka Kit	2/2	—	1/1
Wong Shun Tak	2/2	2/2	1/1

The Company shall hold regular Board meetings at least four times a year involving active participation of a majority of Directors, and the chairman of the Board shall hold meetings with independent non-executive Directors without the presence of other Directors in a financial year.

The Board would meet at least four times a year in the future, at approximately quarterly intervals, and the chairman of the Board would hold at least one meeting a year with the independent non-executive Directors without the executive Directors present. Schedules for regular Board meetings are normally agreed with Directors in advance to facilitate their attendance. At least 14 days' notice for all regular Board meetings will be given to all Directors and all Directors are given the opportunity to include items or businesses for discussion in the agenda. For all other Board meetings, reasonable notice will be given. Relevant agenda and accompanying meeting papers will be sent to all Directors in a timely manner and at least three days in advance of every regular Board meeting.

Board Committees

The Board has established four Board committees, namely, the Audit Committee, the Corporate Governance Committee, the Nomination Committee and the Remuneration Committee, for overseeing particular aspects of the Company's affairs. All Board committees are established with specific written terms of reference which deal clearly with their authority and duties, and are posted on the Company's website and the Stock Exchange's website.

Audit Committee

The Company has established the Audit Committee in compliance with Rule 3.21 of the Listing Rules and the CG code. The primary duties of the Audit Committee are to review and supervise the financial reporting process and internal controls system of the Group, review and approve connected transactions and to advise the Board. The Audit Committee comprises one non-executive Director and two independent non-executive Directors, namely, Chen Dongsheng, Koh Tuck Lye and Wong Shun Tak. Wong Shun Tak, who possesses the appropriate professional qualification, and accounting and financial management expertise as required under Rule 3.10(2) of the Listing Rules, is the chairman of the Audit Committee.

None of the members of the Audit Committee is a former partner of the Company's existing external auditor, PricewaterhouseCoopers.

The Audit Committee has performed the following major tasks during the Report Period:

- Reviewed the unaudited interim results of the Group for the three and six months ended June 30, 2018; and the unaudited third quarterly results of the Group for the three and nine months ended September 30, 2018.

- Discussed matters with respect to effectiveness of the Company's financial reporting system, the system of internal control in operation, risk management system and associated procedures within the Group with senior management members, internal auditors and the Auditor.

- Reviewed the plans, resources and work of the Company's internal auditors.

- Reviewed the continuing connected transactions of the Group carried out during the year ended December 31, 2018.

- Reviewed the risk management and internal control systems of the Group.

- Discussed and made recommendation on the re-appointment of the Auditor.

- Reviewed the independence of PricewaterhouseCoopers and engagement of PricewaterhouseCoopers for annual audit for the year ended December 31, 2018.

The Auditor was invited to attend the Audit Committee meetings to discuss with the Audit Committee on issues arising from the audit and financial reporting matters. The Audit Committee also met with the Auditor without the presence of the executive Directors. The Audit Committee is satisfied with the independence and engagement of the Auditor. As such, the Audit Committee has recommended its re-appointment.

Corporate Governance Committee

The Company has established the Corporate Governance Committee in compliance with Rule 8A.30 of the Listing Rules and the CG Code. The primary duties of the Corporate Governance Committee are to ensure that the Company is operated and managed for the benefit of all Shareholders and to ensure the Company's compliance with the Listing Rules and safeguards relating to the weighted voting rights structure of the Company. The members of the Corporate Governance Committee are the independent non-executive Directors, namely, Chen Dongsheng, Lee Ka Kit and Wong Shun Tak. Chen Dongsheng is the chairman of the Corporate Governance Committee.

The following is a summary of work performed by the Corporate Governance Committee during the Report Period:

- Reviewed the policies and practices of the Company on corporate governance and on compliance with legal and regulatory requirements. The policies reviewed include Code for Securities Transactions by Directors and Relevant Employees, Board Diversity Policy, Shareholders' Communication Policy, Procedures for Nomination of Director by Shareholders, Disclosure of Information Policy, Connected Transactions Policy and Whistle-blowing Policy.

- Reviewed the Company's compliance with the CG Code and the deviation from code provision A.2.1 of the CG Code and the Company's disclosure for compliance with Chapter 8A of the Listing Rules.

- Reviewed the management of conflicts of interests and risks relating to the weighted voting rights structure, and reviewed the relevant measures adopted by the Company, and made relevant recommendations to the Board to ensure good corporate governance standards and to avoid potential conflicts of interest between the Group/the Shareholders on one hand and the beneficiaries of weighted voting rights on the other.

- Reviewed the arrangements for the training and continuous professional development of Directors and senior management (in particular, Chapter 8A of the Listing Rules and knowledge in relation to risks relating to the weighted voting rights structure).

- Reported on the work of the Corporate Governance Committee covering all areas of its terms of reference.

Subsequent to the Report Period, the Corporate Governance Committee has held one meeting, in which the committee members have reviewed and confirmed that (i) the beneficiaries of weighted voting rights have been the Directors throughout the Report Period and no matters under Rule 8A.17 of the Listing Rules have occurred during the Report Period; and (ii) the beneficiaries of weighted voting rights have complied with Rules 8A.14, 8A.15, 8A.18 and 8A.24 of the Listing Rules throughout the Report Period.

Nomination Committee

The Company has established the Nomination Committee in compliance with Rule 8A.27 of the Listing Rules and the CG code. The primary duties of the Nomination Committee are to review the Board composition, make recommendations to the Board regarding the rotation and appointment of Directors and Board succession, and assess the independence of independent non-executive Directors of the Company. The Nomination Committee comprises one executive Director and two independent non-executive Directors, namely, Lin Bin, Lee Ka Kit and Wong Shun Tak. Lee Ka Kit is the chairman of the Nomination Committee.

As the Company was listed on the Stock Exchange on the Listing Date, no Nomination Committee meeting was held during the Report Period. Subsequent to the Report Period, the Nomination Committee has held one meeting, in which the committee members has (i) reviewed the structure, size and composition of the Board to ensure that it has a balance of expertise, skills and experience appropriate to the requirements for the business of the Group; (ii) assessed the independence of all the independent non-executive Directors; and (iii) recommended the re-election of the retiring Directors at the forthcoming annual general meeting.

The Company recognizes and embraces the benefits of having a diverse Board and sees increasing diversity at the Board level as an essential element in maintaining the Company's competitive advantage and enhancing its ability to attract, retain and motivate employees from the widest possible pool of available talents.

A Board diversity policy was adopted by the Company, pursuant to which the Nomination Committee is responsible for reviewing the Board composition by considering a number of aspects, including but not limited to gender, age, cultural and educational background, professional qualifications, skills, knowledge, and industry and regional experience. The Nomination Committee would discuss periodically and, where necessary, agree on the measurable objectives for achieving diversity on the Board and recommend them to the Board for adoption. The Company aims to maintain an appropriate balance of diversity perspectives that are relevant to the Company's business growth. The Company is also committed to ensure that recruitment and selection practices at all levels are appropriately structured so that a diverse range of candidates are considered. The Nomination Committee shall report its findings and make recommendation to the Board to complement the Company's corporate strategy and to ensure that the Board maintains a balanced diverse profile.

CORPORATE GOVERNANCE REPORT

The Nomination Committee considered an appropriate balance of diversity perspectives of the Board is maintained and has not set any measurable objective implementing the Board diversity policy.

During the Report Period, in response to the amendment to the CG Code effective on 1 January 2019, the Company has also adopted a nomination policy for election of Directors. Such policy, devising the criteria and procedures of selection and performance evaluation, provides guidance to the Board on nomination and appointment of Directors of the Company. The Board believes that the defined selection process is good for corporate governance in ensuring the Board continuity and appropriate leadership at Board level, and enhancing Board effectiveness and diversity.

The Nomination Committee and the Board may nominate candidates for directorship. In assessing the suitability and the potential contribution to the Board of a proposed candidate, the Nomination Committee may make reference to certain selection criteria, such as reputation for integrity, professional qualifications and skills, accomplishment and experience in the internet and technology markets, commitment and relevant contribution, diversity in all aspects. The Nomination Committee shall report its findings and make recommendation to the Board on the appointment of appropriate candidate for directorship for decision and succession planning. The ultimate responsibility for selection and appointment of Directors rests with the entire Board.

Remuneration Committee

The Company has established the Remuneration Committee in compliance with Rule 3.25 of the Listing Rules and the CG code. The primary duties of the Remuneration Committee are to review and make recommendations to the Board regarding the terms of remuneration packages, bonuses and other compensation payable to the Directors and senior management. The Remuneration Committee comprises one executive Director and two independent non-executive Directors, namely, Lei Jun, Chen Dongsheng and Wong Shun Tak. Chen Dongsheng is the chairman of the Remuneration Committee.

As the Company was listed on the Stock Exchange on the Listing Date, no Remuneration Committee meeting was held during the Report Period. Subsequent to the Report Period, the Remuneration Committee has held one meeting, in which the committee members have reviewed and made recommendations on the remuneration packages of the Directors and senior management of the Company.

Pursuant to code provision B.1.5 of the CG Code, the annual remuneration (including share-based compensation) of the members of senior management, including those members of senior management who are also the executive Directors[1], by band for the year ended December 31, 2018 is set out below:

Annual Remuneration	Number of individuals
HK$0 to HK$10,000,000	2
HK$10,000,001 to HK$30,000,000	1
HK$30,000,001 to HK$100,000,000	10
HK$100,000,001 to HK$150,000,000	0
HK$150,000,001 to HK$15,000,000,000	1

Further details of the remuneration for the year ended December 31, 2018 are set out in Note 10 to the consolidated financial statements contained in this annual report.

Risk Management and Internal Controls

The Board acknowledges its responsibility for the risk management and internal control systems and reviewing their effectiveness. Such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and they can only provide reasonable, but not absolute, assurance against material misstatements or losses.

The Board has the overall responsibility for evaluating and determining the nature and extent of the risk of failure to achieve the Company's strategic objectives, as well as establishing and maintaining effective risk management and internal control systems.

The Audit Committee assists the Board in leading the management team to oversee the design, implementation and monitoring of the risk management and internal control systems.

Note:

(1) Senior management as of December 31, 2018.

CORPORATE GOVERNANCE REPORT

The management considers it is important to establish and to continue to improve its risk management and internal control systems, and has strengthened internal control, internal audit, compliance and forensic functions of the Company during the Report Period. The Company's risk management and internal control systems have been developed with the following principles and processes:

Organization principles:

In accordance with COSO framework[1], the Three Lines of Defense Model has been implemented:

The First Line of Defense — Management and Operation:

The First Line of Defense is mainly formed by the business and functional departments of the Company which are responsible for the day-to-day operations, and they are responsible for designing and implementing control measures to address the risks.

The Second Line of Defense — Risk Management, Internal Control and Other Functions:

The Second Line of Defense is mainly implemented by the Internal Control team, which is responsible for formulating policies, designing and implementing integrated risk management and internal control systems. To ensure effective implementation of such systems, this line of defense also assists and supervises the First Tine of Defense in the establishment and improvement of control measures.

The Third Line of Defense — Internal Audit and Forensic:

The Third Line of Defense is mainly implemented by the the Internal Audit and Forensic teams, which hold a high degree of independence. They provide an evaluation on the effectiveness of the Company's risk management and internal control systems, and monitor management's continuous improvement over these areas.

The Forensic team is responsible for receiving whistle-blowing reports and investigating alleged fraudulent incidents.

The Internal Audit and Forensic teams directly report to the Audit Committee.

Noted:

(1) the Internal Control Integrated Framework issued by the Committee of Sponsoring Organisations.

Risk Management Process:

All departments conduct internal control assessments regularly to identify risks that potentially impact the business of the Group.

The Internal Audit team is responsible for performing independent reviews of the adequacy and effectiveness of the risk management and internal control systems. The Internal Audit team examines key issues in relation to the accounting practices and all key internal controls, and provide its findings and recommendations to the Audit Committee.

The Board, supported by the Audit Committee and management, reviewed the management reports and the internal audit reports. For the Report Period, the Board considered the risk management and internal control systems of the Company effective and adequate.

The Company has developed its disclosure policies which provide a general guide to the directors, officers, senior management and relevant employees of the Company in handling confidential information, monitoring information disclosure and responding to enquiries. Control procedures have been implemented to ensure that unauthorized access and the use of insider information are strictly prohibited.

Significant risks of the Company:

In the Report Period, through its risk management process, the Company identified significant risks of the Company, which have been reported to the Audit Committee. Measures have been designed and implemented by the management accordingly:

1. Market competition and technology innovation:

   Uncertainties arising from macro-economic trends and global trade environment make it more challenging to achieve the business objectives of the Company. Global markets for our products and services are highly competitive. New technologies such as 5G and AI, etc. keep evolving and customers' desire for innovative products and services is also continuously increasing. If we fail to maintain the progress of technology development, the core competitiveness of the Company may be affected.

CORPORATE GOVERNANCE REPORT

The management pays close attention to macro-economic trends, continuously invests in new technologies, and provides innovative products and services to customers. In 2018, Xiaomi's investment in R&D was RMB5.8 billion, an increase of 83% compared to the previous year, achieving a compounded annual growth rate of 66% over the past three years. To maintain and increase global market share and maximize revenue, the Company will continue to develop innovative products, expand into new markets globally, and increase penetration in existing markets.

2. Product and service quality risk:

Quality problems of our hardware products and internet services may seriously affect customer experience, and damage the Company's brand name and reputation significantly.

Management regards quality as the foundation of the Company. As quoted from CEO of the Company, "Innovation determines how high we can fly, quality determines how far we can go". The Company has established a Quality Committee in the Report Period and a series of quality policies and processes have been designed and implemented across all products and services. Company-wide improvement programs are led by this committee. In each business line, product quality engineers monitor the quality of products and services throughout their life cycle. All quality incidents and problems are reported to this committee and actions are taken to mitigate product and service quality risks.

3. Supplier risk:

The Company's core products are highly dependent on suppliers to supply raw materials and components. In particular, the import of high-end products are subject to the supply of upstream components. Certain core raw materials and components are supplied from limited sources, or even from a single source, Products can be subject to delay or constrained shipment. Products can also be subject to pricing risk, including from components that are available from multiple sources, due to industry-wide shortages and significant commodity pricing fluctuations.

The Company has set up a sourcing pool to ensure sufficient and timely supply of common materials and components. For customized components, the Company has invested in researching and developing replacement solutions, and the Company has established strategic relationship with core suppliers to lower the supplier risks. Additionally, the Company has established a series of policies and processes to select suppliers, to monitor products quality and supply chain delivery performance, as well as to enhance social responsibility.

4. Compliance risk:

With the accelerated pace of international expansion, the Company is facing various regulations and compliance requirements from different countries, e.g. labor, anti-trust, anti-corruption, accounting, taxation, and privacy requirements (including the General Data Protection Regulation), etc. Any non-compliance incidents may damage the Company's brand and reputation. Additionally, any violation of laws and compliance requirements may result in the Company facing severe penalties, or even significantly impacting the business operations of the Company.

The Company's legal team and internal control team are working together to establish the global compliance framework to mitigate any relevant risks. The Company has established policies and procedures to fulfill global compliance requirements, and has also implemented a whistle-blowing system. It also periodically provides compliance trainings to raise compliance awareness for all employees of the Company, business partners and suppliers.

5. Information security & privacy risks:

The Company's business is highly dependent on information security. Any information security incidents may impact on the continuity of business operations. Some of the Company's products and services will collect some user data. The protection of user data is the top priority of the Company. The management is fully aware that any loss or leakage of user data will lead to significant impacts on users and the Company's reputation. Furthermore, any leakage of sensitive business data of the Company to its competitors may damage Company's competitive advantages.

The Company has established a Security and Privacy Committee to formulate sensitive business information policy and implement procedures to protect data security throughout the entire data life cycle. The Company has deployed a system to effectively monitor any possible data leakage incidents. Additionally, a dedicated information security team has been set up and is responsible for implementing a proactive security management system within the Company. This information security team delivers periodical trainings to raise employee's awareness.

CORPORATE GOVERNANCE REPORT

Directors' Responsibilities in Respect of the Financial Statements

The Directors acknowledge their responsibilities for preparing the financial statements of the Company for the year ended December 31, 2018.

The Board is responsible for presenting a balanced, clear and understandable assessment of annual and interim reports, inside information announcements and other disclosures required under the Listing Rules and other regulatory requirements. The senior management has provided to the Board necessary explanation and information to enable the Board to make an informed assessment of the financial information and position of the Company, which are put forward to the Board for approval.

The Directors are not aware of any material uncertainties relating to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

The statement of the Auditor about their reporting responsibilities on the Company's consolidated financial statements for the year ended December 31, 2018 is set out under the section headed "Independent Auditor's Report" in this annual report.

Auditor's Remuneration

The fees paid/payable to the Auditor in respect of audit services and non-audit services for the year ended December 31, 2018 are analyzed below. The amount of audit service fee also included the service fees in connection with the initial public offering. The non-audit services conducted by the Auditor mainly include professional services on tax advisory and internal control consultation services.

Type of services provided by the Auditor	Fees paid/payable (RMB'000)
Audit services:	41,332
Non-audit services:	13,333
Total	**54,665**

Joint Company Secretaries

Steve Lin, the joint company secretary of the Company, is responsible for advising the Board on corporate governance matters and ensuring that the Board policies and procedures, as well as the applicable laws, rules and regulations are followed.

So Ka Man of Tricor Services Limited, an external service provider, has been engaged by the Company as the other joint company secretary to assist Steve Lin to discharge his duties as the joint company secretary of the Company. The primary contact person at the Company is Steve Lin.

During the Report Period, Steve Lin and So Ka Man have taken the required number of hours of relevant professional trainings.

Communications with Shareholders and Investors

The Board believes that effective communication with the Shareholders is essential for enhancing investor relations and investors' understanding of the Group's business performance and strategies. The Group also recognizes the importance of transparency and timely disclosure of its corporate information, which enables the Shareholders and investors to make the best investment decision.

The Company maintains a website at "www.mi.com" as a communication platform with the Shareholders and investors, where information on the Company's announcement, financial information and other information are available for public access. Shareholders and investors may send written enquiries or requests to the Company, for the attention of the Board of Directors, as follows:

Address: Level 54, Hopewell Centre, 183 Queen's Road East, Hong Kong
Email: ir@xiaomi.com

The Company continues to enhance communications and relationships with its shareholders and investors. Designated senior management maintains regular dialogue with institutional investors and analysts to keep them posted of the Company's developments. Enquiries from shareholders and investors are dealt with in an informative and timely manner.

General meetings can provide an opportunity for communication between the directors, senior management and the Shareholders. The Board welcomes views of the Shareholders and encourages them to attend general meetings to raise any concerns they might have with the Board or the management directly. Board members and appropriate senior management of the Company are available at such meetings to respond to enquiries raised by the Shareholders.

The Company has adopted a Dividend Policy on payment of dividends. The Company do not have any pre-determined dividend payout ratio. Depending on the financial conditions of the Company and the Group and the conditions and factors as set out in the Dividend Policy, dividends may be proposed and/or declared by the Board during a financial year and any final dividend for a financial year will be subject to the Shareholders' approval.

CORPORATE GOVERNANCE REPORT

Shareholders' Rights

To safeguard the Shareholders' interests and rights, separate resolutions are proposed at the Shareholders' meetings on each substantial issue, including the election of individual directors, for the Shareholders' consideration and voting. All resolutions put forward at the Shareholders' meetings will be voted by poll pursuant to the Listing Rules and poll results will be posted on the websites of the Company (www.mi.com) and the Stock Exchange after each Shareholders' meeting.

Pursuant to the Articles of the Company, extraordinary general meetings shall be convened on the written requisition of any one or more Shareholders holding, as of the date of deposit of the requisition, in aggregate shares representing not less than one-tenth of the paid up capital of the Company which carry the right of voting at general meetings of the Company. A written requisition shall be deposited at the principal office of the Company in Hong Kong to the Board or the joint company secretaries for the purpose of requiring an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition. Such meeting shall be held within two months after the deposit of such requisition. If within 21 days of such deposit, the Board fails to proceed to convene such meeting, the requisitionist(s) themselves may convene the general meeting in the same manner, and all reasonable expenses incurred by the requisitionist(s) as a result of the failure of the Board shall be reimbursed to them by the Company.

For the avoidance of doubt, Shareholders must deposit and send the original duly signed written requisition, notice or statement (as the case may be) to the Company's principal place of business in Hong Kong and provide their full name, contact details and identification in order to give effect thereto. Shareholders' information may be disclosed as required by law.

There is no provision allowing the Shareholders to move new resolutions at general meetings under the Cayman Islands Companies Law or the Articles. Shareholders who wish to move a resolution may request the Company to convene a general meeting following the procedures set out in the preceding paragraph.

With respect to the Shareholders' right in proposing persons for election as Directors, please refer to the procedures available on the website of the Company.

Pursuant to a special resolution of the Shareholders passed on June 17, 2018, the sixteenth amended and restated memorandum and articles of association of the Company was adopted with effect from the Listing Date. Save as disclosed above, during the year ended December 31, 2018, there was no significant change in the memorandum and articles of association of the Company.

The Articles of the Company is available on the websites of the Stock Exchange and the Company.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

We deeply understand that it is positive for our society if we actively fulfill our corporate social responsibility ("CSR") and advocate the corporate values of entrepreneurship and kindness while always focusing on creating quality products. It is also a necessary path to achieve our mission and vision.

Lei Jun

1. Overview of Xiaomi's CSR

1.1 Xiaomi's CSR programs in 2018

In 2015, the United Nations ("**UN**") adopted *Transforming Our World: the 2030 Agenda for Sustainable Development* and proposed 17 sustainable development goals ("**SDGs**"), which aim to mobilize global efforts to solve problems including poverty, hunger and climate change between 2015 and 2030.

Against the background of globalization, Xiaomi has a strong understanding of the economic, environmental and social challenges faced by human beings. We take a global view of the connection between our own development and the world, respond actively to the UN SDGs through identifying the priorities for the SDGs in light of the Group's industry attributes, and continue to take actions related to the Group's four core CSR areas including products, users, environment and society.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

UN SDGs	Xiaomi 2018 Achievements

Products

- Setting up the Quality Committee at group level, putting quality first;
- Implementing strict product quality, health and safety management;
- Winning the "Top Prize of China Quality Technical Award", the highest award in the field of quality in China in the 2018 annual conference of China Association for Quality;
- Winning the "2018 National Quality Benchmark Prize";
- Patent portfolio including over 16,000 pending patents applications and over 10,000 issued patents;
- Winning the "iF Gold Award", "iF Design Award", "IDEA Gold Award", "Good Design Award", "Red Dot Design Award", "DFA Design for Asia Award" and "China Red Star Design Award";
- Investing in more than 100 ecosystem partners, changing hundreds of industries;
- Pledging that Xiaomi's hardware business net margin would never exceed 5%;
- Implementing comprehensive management for user privacy and information security;
- Carrying out "Xiaomi Smart Life Security Protection Program" with one million RMB prize to create a safe ecosystem.

Users

- Establishing participation by involving users in creating products, delivering services, branding and sales, so as to create a brand that grows together with users;
- Developing numerous humanized functions;
- Ensuring the processing time within 24 hours for after-sales maintenance;
- Building more than 500 maintenance outlets providing carry-in services nationwide, more than 350 maintenance outlets providing home-delivery services, 5 delivery-repair centers; 30 provincial delivery-repair centers and 8 spare parts warehouses;
- As of December 31, 2018, the number of Mi Homes in mainland China had reached 586, and that of authorized stores of Xiaomi in mainland China had reached 1,378. At the same time, Mi Homes are also popular among consumers globally;
- The number of registered users of our Mi Community exceeded 130 million;
- Actively promoting the development of information accessibility design standards and the development and application of accessibility functions, facilitating information accessibility construction by an Internet development model with user's engagement, which have been highly recognized by the UN Educational, Scientific and Cultural Organization ("UNESCO").

Environment

- Promoting paperless office, saving about 1,153,220 pieces of papers throughout the year;
- Centralizing the recycling of office waste, reducing an estimated 8 million disposable plastic bags throughout the year;
- Energy saving product design;
- Package quantity reduction design and the usage of environment-friendly packaging materials;
- Holding the 2018 "Orange Run", incorporating the theme of environmental protection into public benefit activities. The activity produced only 41.26 kilograms of waste (excluding structures), of which 88% was recycled.

Society

- Building a harmonious employment relationship;
- Promoting employee diversity, with more than 16,000 employees from 44 countries;
- Sound health and safety management;
- Prohibiting child labor or forced labor;
- Providing rich resources for employee development and training;
- Establishing more than 14 employee clubs in total, with the attendance to each club exceeding 500 employees, so as to help employees realize work-life balance;
- Xiaomi won the "Human Resources Management Best Practice Award" at the 2018 China Annual Conference for Human Resources Management (Eleventh) and the Eighth Awarding Ceremony for China Human Resources Management Academy Award;
- From 2016 to 2018, Xiaomi invested more than RMB100 million accumulatively in public benefit donations (including the Group's donation and Lei Jun's personal donation);
- Xiaomi won the "Best CSR Brand Award" and won the "CSR China Education Award" with the project "Targeted Poverty Alleviation for the Disabled to Realize the China Dream" as the award-winning project at the third "CSR China Education Awards" ceremony in 2018.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

2. Sincerity and Passion — Overview of Xiaomi's CSR

2.1 Who is Xiaomi? What does Xiaomi strive for?

Xiaomi's mission is "to relentlessly build amazing products with honest prices to enable everyone in the world to enjoy a better life through innovative technology", and Xiaomi's vision is to "be friends with our users, and be the coolest company in the hearts of our users". Since its establishment, Xiaomi's mission and vision have motivated us to pursue innovation and perfection. For the past eight years, Xiaomi, together with entrepreneurs who share the same core values, has changed more than one hundred industries and affected the lives of hundreds of millions of people around the world.

2.2 CSR concept

The core of Xiaomi's CSR concept is to improve people's lives through technology and become a respectable corporate citizen. With "products, users, environment and society" as the four core CSR areas, we actively fulfill our corporate responsibility and adhere to sustainable development, by pursuing equal and inclusive business environment, innovative technology and outstanding design in our products. We also adhere to the people-oriented principle, and comply with the code of conduct, attaching importance to environmental protection and investing in community capacity building.

2.3 ESG strategy

Xiaomi integrates ESG as a part of its strategy and promotes CSR work around five key dimensions including products, operation, users, environment and society, in order to facilitate CSR management consistently and to make an ongoing contribution in the field of sustainable development.

2.4 CSR management structure

The Board of Directors is responsible for overall CSR management. In addition, Xiaomi has established the CSR management team, which coordinates across main businesses and departments, in order to guide the overall implementation of our CSR policies in relation to products, operations, users, environment and society.

2.5 Communication with stakeholders

Xiaomi actively listens to and responds to the expectations of stakeholders. Based on the attributes of Xiaomi's businesses and operations, we have identified internal and external stakeholders including customers and users, investors, employees, suppliers and partners, government and regulatory agencies, public benefit organizations and other social groups, news media, etc. In addition, we took the initiative to establish communication mechanisms with stakeholders, and maintain smooth and timely communication and feedback through diversified online and offline communication channels including shareholders' meetings, MIUI Forums, supplier conferences, staff communication meetings, etc.

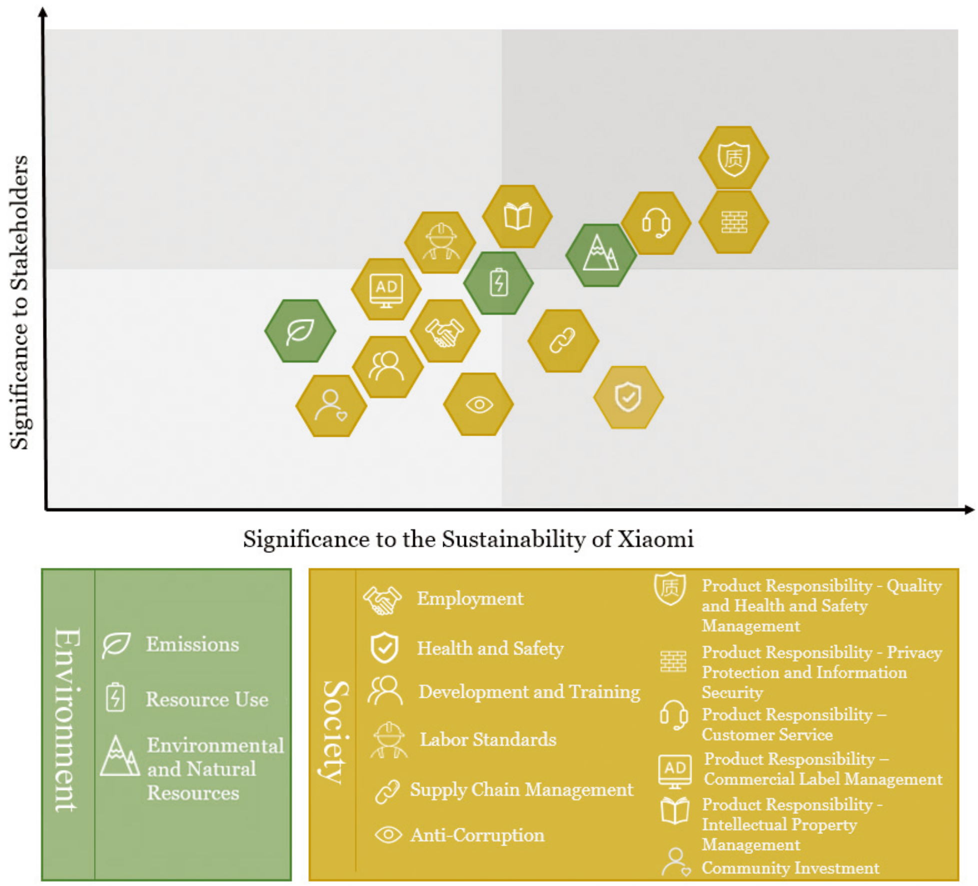
Key stakeholders	Key considerations	Major communication channels
Governments and regulators	Compliance Anti-corruption The environment and natural resources	Policy consultation Event reporting Site inspection Information disclosure Meetings with government agencies
Shareholders and investors	The Company's business performance Industry risks Compliance	Shareholders' meetings Annual reports/interim reports/ results announcements Meetings with investors Results release conferences News releases/announcements
Consumers/users	Quality of products and services Marketing compliance	Official website Social platforms such as MIUI Forums Instant messaging software Customer service hotline Press conferences Social media
Employees	Employment Health and safety Development and training Labor standards	Staff communication meetings Instant messaging software
Suppliers/partners	Supply chain management Anti-corruption	Supplier conferences Communication meetings with partners Invitations to bid Site invitations
Media and NGOs	Emissions Use of resources The environment and natural resources Employment Supply chain management Product responsibility	Social media Press conferences and news releases Interviews
Community	Emissions Use of resources The environment and natural resources Community investment	Community activities Press conferences Public benefit activities Social media

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

2.6 Materiality assessment

In 2018, through ongoing communication with major stakeholders and based on 568 special investigation questionnaires (valid questionnaires collected), we conducted substantive analysis on the ESG issues in the 11 aspects set out in the *ESG Reporting Guide*, to learn more about the comments and expectations of stakeholders on Xiaomi's ESG management and take actions on these, so as to better respond to stakeholders.

Based on the ESG Reporting Guide, important considerations we have identified include product responsibility, supply chain management and information safety. Relevant issues identified include emissions, use of resources, the environment and natural resources, employment, health and safety, development and training, labor standards and community investment. We will discuss each issue separately in this report.



3. Gift Warmth to Technology

Xiaomi has always been committed to building amazing products. With product quality as the core strategy and technology innovation as the development driver, Xiaomi maintains an unwavering focus on high quality and outstanding design to create a globalized open ecosystem.

3.1 Quality management — the lifeline of Xiaomi

With quality as a core strategy, Xiaomi considers product quality as its lifeline. Xiaomi does not compromise on quality control as quality is the basis for providing amazing products.

System guarantee, sustainability and stability

Xiaomi is deeply aware that we can address complex quality risks relating to our diversified businesses only by establishing a comprehensive, stable and efficient quality management system. Following the requirements of GB/T19001-2016/ISO9001:2015 quality management system, Xiaomi has established a product quality control system and is committed to continuously improving product quality.

Supervision mechanism with full employee participation

For the overall implementation of the Group's quality control concept and requirements, Xiaomi has set up a pyramid-structured quality management system and established a quality supervision mechanism with full employee participation.

Quality Committee: The committee is composed of business leaders who are responsible for overall quality control of their respective business lines;

Quality Promotion Team: The team is led by heads of quality departments from each business line, who carry out the quality management work for their respective business lines;

Quality Observers: Internal employees perform in-depth observation to identify deficiencies in the department management process, product quality, service quality and user experience, comment on these deficiencies and adopt specific strengthening measures.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

At the inaugural meeting of the Quality Committee on July 23, 2018, Lei Jun and the Group's senior executives stressed the policy of "quality first". All departments of the Group are to give top priority to quality and regard the improvement of quality (including product quality and user experience) as the driving force of business development.

The Group often organizes business leaders to listen to users' feedback directly from customers, to understand consumer's concerns over quality.

In addition to overall quality control, we are also committed to promoting the company wide quality culture to raise the quality awareness of employees.

Xiaomi Corporation is engaged in various product categories, including not only technology products such as smartphones, televisions and ecosystem hardware products but also financial services such as micro lending. We regard service as a product with service quality equivalent to product quality, and we have established a sound quality assurance policy and system. We have a complete monitoring system for access permission , process control and post-maintenance, for all business proposals in order to enhance the completeness and reliability of products and functions.

Health and safety, and standard compliance

Product health and safety is also very important to the overall quality control of Xiaomi's products. We carry out continuous assessment of product health and safety over our products' life cycle from R&D, material selection, development verification, product launch to aftersales.

SGS

Test Report

Date: 16 Mar 2018 Page 1 of 5

The following sample(s) was/were submitted and identified on behalf of the clients as : PMMA CM-205

Model No. :	PMMA
Manufacturer :	CHIMEI
Date of Sample Received :	12 Mar 2018
Testing Period :	12 Mar 2018 - 16 Mar 2018
Test Requested :	Selected test(s) as requested by client.
Test Method :	Please refer to next page(s).
Test Results :	Please refer to next page(s).

Signed for and on behalf of

Approved Signatory

After the launch of products, Xiaomi regularly reviews the compliance reports provided by the suppliers and continuously monitors the health and safety of products provided by the suppliers.

Xiaomi has always attached importance to the standardization of material safety. We participate in drafting the industrial standards for green products evaluation, and we developed enterprise standards related to material safety with stringent requirements. Xiaomi actively participates in and leads domestic standardization work, covering national, industrial and group standards in various areas including smart home appliances, drones, green design, AI, cloud computing, big data, biometric identification and sensors, fast charging, wireless charging, lithium-ion batteries, intelligent terminal devices, material safety, etc. Xiaomi is one of the major drafters of national standards in the fields of wearable devices, connectivity and smart home appliances.

Pursuing perfection, and gaining recognition

> **"We look at innovation through a telescope and quality through a microscope. Innovation determines how high we can fly, and quality determines how far we can go."**

With quality as a strategic focus, Xiaomi has invested greatly in quality management, the results of which were highly recognized by the industry and by society in 2018.

At the 2018 Annual Conference of China Association for Quality, Xiaomi won the "Top Prize of China Quality Technical Award". Xiaomi became the first Internet company to receive this highest recognition honor in China regarding quality technology.

Xiaomi won the "2018 National Quality Benchmark Prize" at the award ceremony of the "2018 National Quality Benchmarking Enterprises", sponsored by the Ministry of Industry and Information Technology of the People's Republic of China. This award is further recognition of Xiaomi's quality improvements.

Quality improvement as an endurance battle

We face many challenges in maintaining high product quality as we expand product categories and we expand into more international markets. "Quality management is an endurance battle, and we have no other way but to persevere", said Lei Jun to all of Xiaomi's employees. As an industry-leading enterprise, Xiaomi strives not only to improve our overall product quality, health and safety, but also to make efforts to promote the overall development of the industry.

> **"Xiaomi is willing to put in 100% effort, for a 1% improvement."**
>
> **— Lei Jun**

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

3.2 Technology innovation, the permanent driving force of our business

"Xiaomi is more than a hardware company, it's an innovation-driven internet company."

Xiaomi has always regarded innovation as a core contributor to its development, and has actively made investments in technology innovation. In 2018, Xiaomi's R&D investment was RMB5.8 billion, and the number of applications for self-developed patents in mainland China and overseas exceeded 3,000.

We place great importance in building a strong IP portfolio and in raising Xiaomi's scientific and technical expertise by acquiring high-quality patents. As of 2018, Xiaomi had acquired approximately 3,000 domestic and overseas patents. In addition, we have entered into licensing or cross-licensing agreements with a number of well-known companies such as Qualcomm, Microsoft, Nokia, and NTT DoCoMo and Via Licensing.

Xiaomi promoted win-win industrial cooperation through innovative licensing models, which won the support and recognition of the industry. As of 2018, the Company's patents portfolio included more than 16,000 pending patents applications and over 10,000 issued patents, of which approximately 50% were obtained from overseas.

On September 6, 2018, Xiaomi announced that it entered into a cellular wireless patent license agreement with NTT DoCoMo, a globally renowned telecommunications company. The agreement covers NTT DoCoMo's cellular wireless standard essential patents (SEP). Xiaomi expressed its willingness to obtain a license to a high-quality SEP portfolio on fair and reasonable terms, so as to bring the best user experience to our customers.

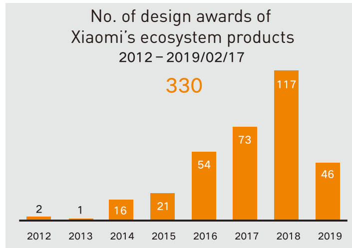
Xiaomi actively conducts scientific research cooperation with prestigious universities including Beijing University of Posts and Telecommunications (BUPT). The cooperation has resulted in a series of high-quality achievements in new 5G technology standards, and it has improved the R&D capacity of both Xiaomi and BUPT.

At the 2018 Mobile Intelligent Terminal Summit, Xiaomi Mi 8 Transparent Explorer Edition won the "2018 METIS Smartphone Award".

Mi 8 Transparent Explorer Edition adopts a wide range of industry-leading technology solutions. It is the world's first Android phone that supports "Face ID", and the world's first smartphone that has an in-display fingerprint sensor and supports dual-frequency GPS.

3.3 Pursuing outstanding design is in Xiaomi's DNA

Pursuing innovative technology and outstanding design is in Xiaomi's DNA. We continue to explore the best balance between technology and aesthetics, promote a bold innovative culture, and refine every detail so that all our products can far exceed users' expectations. We have the courage to break through conventions and constantly improve ourselves. We believe these are the key reasons why we have been able to gain our users' trust and appreciation.



In recent years, Xiaomi has obtained recognition from users and the industry for its continuous pursuit of outstanding design.

Several of our smartphones won the iF Design Award, including Mi MIX, Mi Note 2, Mi MIX 2, Mi 6, and Mi MIX 3. 14 Xiaomi ecosystem products were awarded iF Design Award, in which Mi Sphere Camera won the iF Gold Award

Mi MIX (mobile phone) won the IDEA Gold Award

Mi MAX 2 won the Red Dot Design Award. Mi Rearview Mirror won the Red Dot: Best of the Best Award

Mi Max 3 and Mi MIX 2 won the Good Design Award

Mi MIX and Xiaomi Redmi Note 4X won the Gold Prize of China Red Star Design Award and the China Red Star Design Award respectively

MIJIA Laser Projector 150" won the DFA Design for Asia Award

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Kickstarting the era of bezel-less display for smartphones

Mi MIX kickstarted the era of bezel-less display for smartphones and Xiaomi continued to be in the leading position in the development of bezel-less display technology.

The innovation in Mi MIX 2 brought forward the second generation of bezel-less display. Compared to the first generation of Mi MIX phone, the screen ratio of 18:9 has revolutionarily shortened the chin of the phone by 12%. The smaller form factor with a wider bezel-less display screen has reached a perfect balance between sizable display and hand-feel. Mi MIX 3 took one step further and was the world's first magnetic full screen slider phone.

A new breakthrough in user interface design

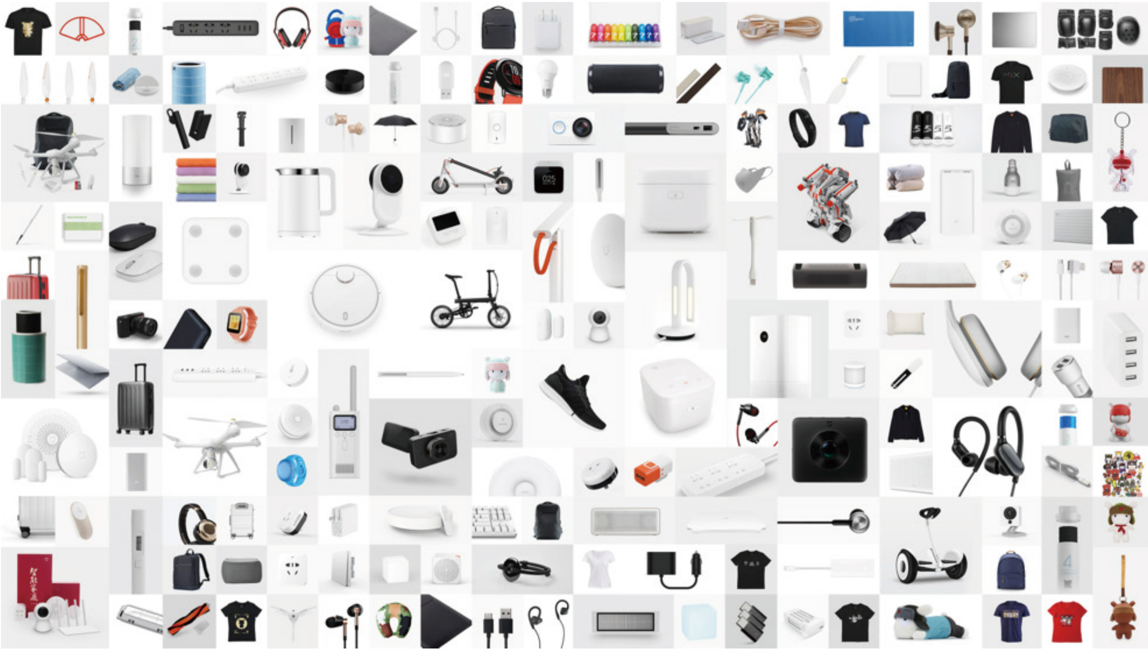
The user interface of Mi Rearview Mirror is displayed in the style of large color blocks to ensure great visualization. Furthermore, it is equipped with our AI Assistant to achieve the control and display of various functions via voice interaction. With regards to driving safety, it is a hands-free voice control smart rearview mirror with functions such as Wi-Fi hotspot, navigation and driving recorder.

Record every moment in 360 degree

Mi Sphere Camera uses an ultra wide angle large aperture lens and a reflective prism to provide a 360-degree panoramic view, which greatly reduces the blind zone at both ends of the camera lens. It has an effective resolution of 23.88 million pixels and is equipped with IP67 waterproof and dustproof body, capable of multiple shooting scenarios to allow photographers to share great moments with family and friends anytime anywhere.

With many award-winning products launched over the years, Xiaomi has formed its own style in industrial design, which is referred as "Mi Look" by industrial designers. In addition to outstanding design, Xiaomi's products also adhere to our philosophy of high quality and high price-to-performance ratio. We make our products affordable to more consumers so as to let everyone enjoy technology.

Alongside efforts in enhancing the industrial design, Xiaomi continues to innovate in product function and system design. MIUI provides users with rich customized features. In order to provide a better user experience, MIUI innovates constantly based on the core ideas of "stability, fluency and rapidity". The release of Mi MIX marks the era of bezel-less display for mobile phones. MIUI puts forward the concept of "bezel-less display user interface design", which better integrates software and hardware designs for bezel-less display, providing users with improved content visualization.



ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

3.4 Limitless potential in the open global ecology

To let everyone in the world enjoy a better life through innovative technology, only one Xiaomi is not enough. Over the years, we incubated and partnered with at least 100 other companies that share the same mission and built a rich and vibrant business ecosystem.

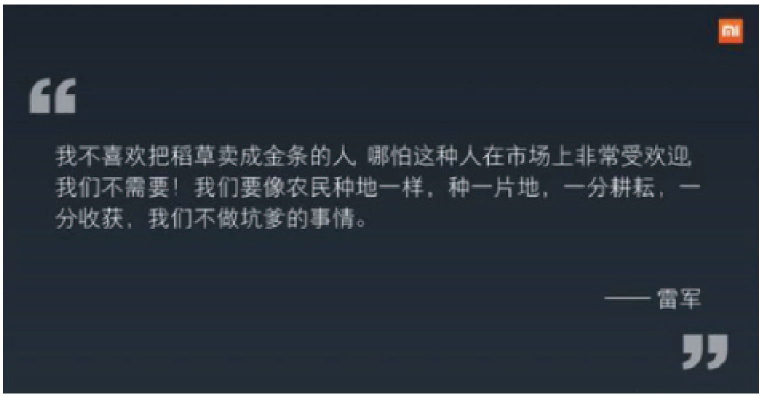
In recent years, Xiaomi has made great efforts in AI, and now has built an AI technical team with more than 1,000 people. Xiaomi is actively strategizing in the IoT industry. Based on the need for smart home solutions, Xiaomi has achieved deep integration in AI and IoT capabilities. Xiaomi has developed "AI Open Platform for Smart Homes" — an open and innovative platform for users, software and hardware suppliers, and individual developers. This platform aims to empower our daily lives with AI so that technology can enhance our quality of life.

Xiaomi "AI Open Platform for Smart Home" was selected as the "World Leading Internet Scientific and Technological Achievements" at the 5th World Internet Conference on July 11, 2018.

"No man is an island." With its unique ecosystem model, Xiaomi has invested in and mobilized many like-minded entrepreneurs. Our mission has no boundaries, and we have only just begun. We have changed the lives of hundreds of millions of people, and we will become part of the lives of billions of people globally in the future.

4. Gift Honesty to Business

4.1 Amazing products with honest prices



Only through building amazing products with honest prices, can we win over the hearts of our users. "Amazing products" and "honest prices" are inseparable. They are the best return to our users' trust. While providing our users with high-quality products and outstanding design, we also insist on honest prices and high price-to-performance ratios.

Based on our innovative business model, we can better understand the real needs of consumers. In the smartphone business, we maintain our enthusiasm in technology and continuously explore cutting-edge technology. We also provide a large number of premium flagship smartphones with high price-to-performance ratios and amazing designs at about half the price of comparable products. In our IoT and lifestyle products business, we put forward the concept of "satisfying 80% of the needs of 80% of the population" for product definition. The first 80% means that our products can cater to the needs of the general public, truly benefit more people and bring convenience and happiness to more people through technology. The second 80% means that our products only focus on mainstream functions, so no extra cost will be added to functions with low usage. This approach of product definition, together with Xiaomi's efficient R&D, design, and retail capabilities, is the recipe for Xiaomi to provide high quality products with high price-to-performance ratios.

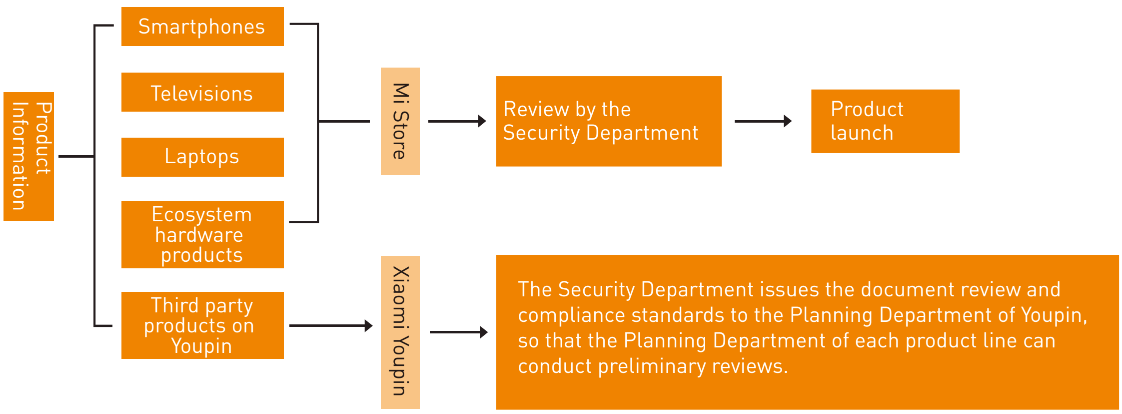
We will firmly uphold our commitment that our hardware business net margin never exceeds 5%. Making reasonable profit is the only way to fulfill our mission. In 2018, Xiaomi's hardware business net margin was positive and less than 1%.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

4.2 Advertisement and trademark management

Advertising management

We strictly abide by the *Advertising Law of the People's Republic of China* and other regulations, and take the protection of user rights as preconditions for advertising. At the group level, the Legal Department, the Security Department and various business departments jointly carry out advertising management work, formulate a sound copywriting review process, and strictly control the content and quality of copywriting. All marketing content is reviewed for compliance requirements by the relevant department, and is only released once approved. Press release contents are also subject to review by the relevant departments. For domestic marketing activities, we have compliance review and regular training in place. Content that may lead to legal risks are submitted to the Legal Department for review, while regular market compliance training is conducted to enhance employees' compliance awareness.



For advertisements on our platform, from the perspective of compliance, we assess the professional qualifications, advertising licenses, advertising material regulations of the specific industries, and the issuance of qualification standards. Our advertising review team collects qualifications and performs review based on regulatory standards.

Brand and trademark management

Xiaomi values the protection of its own brands and trademarks, and respects the trademark rights legally owned by others. We have a professional team responsible for the registration, maintenance, promotion, protection and management of trademarks/brands. We have established a comprehensive trademark application system around the world to provide comprehensive protection for the company's core and important trademarks. A comprehensive trademark monitoring system has been established around the world to formulate effective dispute resolution strategies, effectively monitor and take necessary actions against third-party trademark squatting. In the process of establishing and maintaining its brand, Xiaomi has always stuck to the attitude of zero tolerance for fake goods, and accordingly set up a professional team responsible for trademark rights protection, and formed a relatively complete brand protection system. For online platform management, we work together with major e-commerce platforms and customs for IP protection and established a brand protection network to reduce the circulation of fake goods and protect the legitimate rights and interests of consumers. From an offline perspective, we have established a comprehensive and effective global system of anti-counterfeiting and rights protection, monitoring products sold by third-party, and actively fighting against infringements such as brand-name imitation. In recent years, through effective cooperation with law enforcement, fake goods worth nearly RMB100 million have been seized, and nearly 10,000 infringement links have been removed from various e-commerce platforms. Through this approach, Xiaomi protects its brand image, and helps consumers avoid substantial losses as well.

4.3 Forming a safe ecosystem while connecting all devices

We attach importance to user privacy protection, and incorporate it into daily business activities through industrial practices. We adhere to a transparent and fair privacy policy, and firmly believe that such practice will win the trust of our users.

To ensure the compliance of privacy policies and processes, a Privacy Protection Committee was established in 2015 to manage customer privacy protection issues. In 2018, the Privacy Protection Committee and representatives from multiple departments formed the Security and Privacy Committee to fully implement information security and oversee privacy protection management.

User privacy protection

We have formulated the *User Privacy Protection Clauses* after comprehensive assessments of all business attributes and risks. By referencing the internationally recognized *Five Criteria for Privacy*, i.e., "Notice/Awareness, Choice/Consent, Access/Participation, Integrity/Security, Enforcement/Redress", we conduct strict systematic management on each product and service to ensure the privacy policy is transparent and fair to our users. This ranges from the privacy impact assessment before the launch of products, to the classification of privacy data during product use and to the final data destruction.

At present, Xiaomi has grown into one of the largest consumer IoT platforms in the world. While enjoying this honor, we are also undertaking greater responsibilities. While big data can enable us to provide our users with better products and services, we also take the protection of privacy seriously. We constantly impose higher standards on ourselves regarding user privacy protection.

We have been working together with TrustArc, an international privacy protection organization, to improve our standards and specifications regarding security and privacy. In 2016, the privacy practice of our MIUI and Mi Store received TRUSTe certification.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Information security management

We believe that AI and IoT are the foundations of the fourth industrial revolution. While they face severe security challenges, they are undeniably critical to the future. Xiaomi is a company that is determined to help build that future. We have established one of the world's largest consumer IoT platforms, with approximately 151 million smart devices (excluding smartphones and laptops) connected to it.

Complying with the laws and regulations of *Cybersecurity Law of the People's Republic of China*《中華人民共和國網絡安全法》, *Regulations on the Management of Information Services for Mobile Internet Applications*《移動互聯網應用程序信息服務管理規定》and *Regulations on Technical Measures for Internet Security Protection*《互聯網安全保護技術措施規定》, the Group established the Xiaomi IoT Security Lab. Professional security personnel conducts vulnerability scans and cyber attack drills. We implemented a wide range of procedures and controls to protect user data and reduce the risk of data leakage. Faced with large, complex product categories, we carry out information security protection on our devices at six levels of potential attack:

1. Certification

Ensure that each device is prefabricated with a different key. Each user is bound to a unique token. Unauthorized operations are prevented due to the relationship between the key and the token.

2. Communication

We safeguard information security through traffic encryption and data signatures and other methods. In 2018, we identified 600 million fraudulent and nuisance calls targeting our users. We blocked 4.1 billion unsolicited advertisements and fraudulent SMS messages.

3. Hardware

We debug interfaces, and introduce security chips to store key information safely.

4. Firmware

We use attestation and anti-degradation protections to prevent firmware from being tampered with.

5. System

We use access controls to prevent malicious software from accessing phone permissions, and prohibit the opening of any communication or management service ports other than miio. In 2018, the secure payment feature blocked 110 million fraudulent requests. Our secure Internet access tool blocked 510 million phishing attempts and 1.5 billion malicious URLs.

6. Application

We provide developers with a mature and reliable software development kit (SDK) and reduce new security risks resulting from the process of further software development. In 2018, our built-in virus scanning removed 300 million viruses, and blocked 238.5 billion attempts to access background applications through a smart learning feature.

We have formulated *Security Specifications on Xiaomi IoT Products* 《小米IoT產品安全規范》 for our ecosystem partners. We specify detailed security requirements and implementation methods to help our ecosystem partners achieve high security standards in their product development.

The challenge of managing a large number of products with finite manpower has led us to introduce a range of automated testing methods. As a result, the scope and efficiency of our information security management has been significantly boosted.

By analyzing the various dimensions of information security, we have adopted risk modelling measures and developed the concept of a full line of defence to further enhance information security capabilities through a comprehensive approach.

Xiaomi also carries out the overall management of supply chain information security. This ranges from modules/components, factories, e-commerce/warehouses, logistics/distributors to our users. In this way, we actively improve information security standards along the entire value chain.

Security needs to be maintained by everyone involved. Xiaomi launched the Smart Life Security Guardian Program and set up an incentive scheme to encourage more of our partners to help us perform an increasing number of security tests. We listen to the voices of our users: everyone can join us to help ensure the security and quality of our products. We will continuously refine our products and resolve any potential problems and risks.

For more information about Xiaomi's privacy and information security management, please visit Xiaomi Security Center website. https://sec.xiaomi.com/

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

4.4 Intellectual property management: recognizing everyone's efforts

While we research and develop IP independently, we respect the need for mutual protection of IP and welcome all efforts in innovation.

We carry out strict IP management in accordance with the relevant laws and regulations such as *Patent Law of the People's Republic of China*《中華人民共和國專利法》, the *Trademark Law of the People's Republic of China*《中華人民共和國商標法》and the *CNNIC Domain Name Dispute Resolution Policy*《中國互聯網絡域名管理辦法》. The Intellectual Property Department, established at the group level, coordinates this work. In addition, IP management specialists in each major business department ensure effective implementation.

Due to our wide range of products, IP management is relatively complicated. At the same time, due to the complexity of IP in the high-tech industry, we have initiated an innovative model of licensing cooperation through negotiation, in order to achieve win-win outcomes. To date, we have entered into licensing or cross-licensing agreements with a number of well-known companies, including Qualcomm, Microsoft, Nokia, NTT DoCoMo and Via Licensing.

In 2018, our efforts in IP management were recognized by the industry. Our IP team was named "Asian Elite Intellectual Property Team" and "Mobile and Telecommunications Team of the Year". Mr. Lin Peng, Vice President of Xiaomi's Department of International Expansion, was honored as one of the global "Top 300 IP Strategists" by IAM Magazine. In the "2018 China Intellectual Property Forum", Xiaomi was rated the "Leading Company in the IP Internet Field". Xiaomi as an entity was awarded the title of "Deputy Director Unit" by the China Anti-Infringement and Anti-Counterfeit Innovation Strategic Alliance (CAASA) of the China Industry-University-Research Institute Collaboration Association (CIUR). Xiaomi was named one of the "Top 10 Most Influential Units in Rights Protection and Anti-fake Products of the Year" for two consecutive years.

4.5 Anti-corruption

Anti-fraud

We have always adhered to the values of honesty and integrity, and maintained an attitude of zero tolerance towards fraud. Strictly abiding by laws and regulations on anti-corruption and anti-bribery, we have strengthened our anti-fraud management. We regard honesty and integrity as important cornerstones for the Group's development.

Anti-fraud policy: The anti-corruption policies issued by the Group explicitly prohibit all types of dishonest behavior, including fraud, corruption, bribery and deceit, as well as any other violation of laws and regulations. We revise our policies on a regular basis to ensure their effectiveness considering the changes in the external environment and the Group's development.

Fraud reporting and investigation: The whistle-blowing reporting system initiated by the Group encourages the reporting of any actual or potential fraud. The system outlines the reporting channels and handling processes, as well as the Group's protection and confidentiality policies for whistle-blowers, to fully protect them. In the case of reports relating to fraud, we organize an anti-fraud investigation team, composed of experienced professionals with in-depth knowledge of fraud and risk management, to conduct independent investigations.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

The Group actively promotes integrity to build an honest corporate culture. In 2018, we launched an online integrity awareness-raising campaign with over 10,000 participants so far and have received positive feedback.

In addition, the Group has actively participated in anti-fraud related organizations such as the Trust and Integrity Enterprise Alliance and the Chinese Corporate Anti-Fraud Alliance. These organizations work together to combat corruption, bribery, fraud and other dishonest behaviors, and have established mechanisms to share information about fraudulent behavior.

Anti-money laundering

In compliance with applicable laws and regulations including the *Anti-Money Laundering Law of the People's Republic of China*《中華人民共和國反洗錢法》, the *Provisions of Financial Institutions on Anti-Money Laundering* and《金融機構反洗錢規定》, the *Measures for the Administration of Anti-Money Laundering and Anti-Terrorism Financing of Internet Financial Institutions (Provisional)*《互聯網金融從業機構反洗錢和反恐怖融資管理辦法(試行)》, the Group organizes its Audit and Treasury departments to jointly conduct anti-money laundering work, including identification and control of businesses that present money laundering risks.

Xiaomi Finance has established an Anti-Money Laundering and Counter-Terrorism Financing team, responsible for the formulation, implementation and revision of relevant processes. The Risk Management Department under this team is responsible for implementing various anti-money laundering measures. It has appointed an Anti-Money Laundering Officer to take charge of day-to-day activities.

Xiaomi has conducted preventative measures against money laundering risk and prepared a contingency plan to handle incidents. If a money laundering risk event occurs, the Risk Management Department will promptly conduct a preliminary assessment and formulate targeted measures. These include, but are not limited to, restricting transactions, delaying settlement and reporting the incident to relevant law enforcement agencies. After that, the investigation team will submit a summary report which reflects the cause, process, follow-up actions and outcomes. It will identify accountability and any underlying deficiencies and will propose measures to avoid new risks.

5. Gift Sincerity To Our Users

"Be friends with our users. Be the coolest company in the hearts of our users."

Every day, our vision "to be friends with our users and to be the coolest company in the hearts of our users" motivates us to pursue innovation and maintain excellent quality and efficiency. In recent years, consumers have moved their attention away from features and brand to user experience. As the online world develops, we constantly seek out how we can be friends with our users, meet their definition of 'cool' and encourage them to interact with us.

5.1 Deep participation; excellent experience

Building user engagement

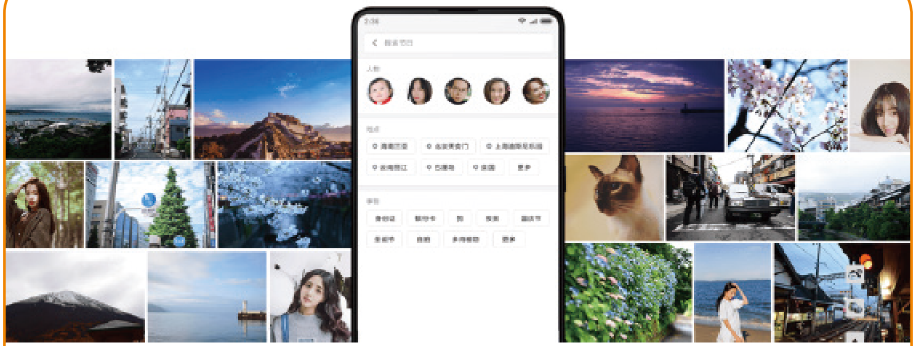
We have always regarded building user engagement as a key part of being friends with our users. We consult our users about every aspect of production, service, branding and sales so that they are engaged in creating a brand that users can access and own, and that they can grow with.

Our Department of Research and Experience Management was set up to better understand users' needs. It is responsible for user research and product experience. We have built a wide range of channels to strengthen communications with our users.

We have appointed specialists to follow up and analyze user feedback. They report feedback directly to colleagues in the relevant business units, and update our users on progress at the same time. Our engineers will promptly make revisions, in order to resolve any critical problems. The staff engaged in products, operations, R&D and design regularly participate in user forums and communicate face-to-face with our users to understand their real needs.

1) Online user surveys
2) Offline focus groups
3) Online user feedback app such as MIUI Forum
4) Core users' WeChat and QQ groups
5) WeChat official account, Weibo, QQ Space and other new media
6) Social organization — Mi Fans
7) Hotline and online customer services

As of 2018, the Department of Research and Experience Management had conducted 57 online surveys and organized 27 offline user forums in more than ten cities, covering over 30 business lines in Xiaomi. They processed more than 300,000 survey responses and had face-to-face, in-depth communications with about 300 users. They collected over 1,000 pieces of effective feedback for each business lines, which provided valuable insights for product improvement.



Case Study: A Mi Fan posted on a forum: "I hope MIUI can support a quick photo search feature." Our product manager followed up and developed solutions as soon as possible. Based on advanced machine learning and image recognition technology, accurate image searching was made possible.

Humanized features

"Be friends with our users" is the foundation for the continuous improvement of MIUI. The core idea of MIUI's ongoing innovation is to develop humanized features that deeply identify our users' pain points and satisfy their needs.

From our users' point of view, in 2018 MIUI presented a more user-friendly experience and a series of innovative features, services and designs through continuous research.

Mi Portal: MIUI leverages our AI capabilities to offer a function that allows users to obtain extensive information under multiple scenarios, such as film reviews, encyclopedias and map, simply by pressing any text area instead of having to leave the app currently used by user.

Innovative NFC-based features: The industry's first NFC digital access card that enables our users to take public transportation and access entrance guard systems via smartphones.

For more information about the features of Xiaomi products, please visit the official website of Xiaomi MIUI: http://www.miui.com/

5.2 World-class after-sales services

Maintenance outlets with fast and secure nationwide coverage

Xiaomi is committed to providing our users with convenient and efficient after-sales services, guaranteeing processing time of 24 hours for regular requests.

500+	Over 500 maintenance outlets provide nationwide carry-in services.
350+	Over 350 maintenance outlets provide nationwide home-delivery services.
30	Five national delivery-repair centers and 30 provincial delivery-repair centers provide nationwide after-sales maintenance services.
8	8 spare parts warehouses ensure that there are enough supplies for the efficient on-site maintenance of the outlets.

Attentive and innovative service model

Xiaomi constantly innovates its service model to give an attentive and reassuring user experience.

60 *Face-to-face maintenance*

We have introduced face-to-face maintenance services at more than 60 outlets nationwide, Our users can watch the disassembly and maintenance process of their mobile phones on site.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

80% *Provincial delivery-repair centers*

Xiaomi was the first manufacturer to launch a provincial delivery-repair center, and has established such centers in 30 provinces in mainland China in 2018. These centers cover counties and towns in the provinces, providing consistent and convenient after-sales services. Over 80% of the products are repaired on the same day of receipt.

5,500 *Integrated sales and service*

In counties and towns, Xiaomi authorizes retail agents who operate our authorized stores and direct supply network to provide after-sales services. The one-stop offering provides better after-sales services for users, Xiaomi offers combined services integrating sales, after-sales, maintenance, delivery and installation in authorized stores in more than 250 counties. After-sales service stations have been built in over 5,500 towns to help users collect faulty devices from users and send them to the provincial delivery-repair centers for maintenance.

1KM *Integrated delivery and installation*

Xiaomi has set up delivery-installation warehouses close to our Mi Homes. Users who purchase TVs from our Mi Homes and Mi.com can enjoy seamless last-mile delivery and installation, increasing installation effectiveness and enhancing user experience.

5 *Establishment of five major delivery-repair centers*

Xiaomi has established delivery-repair centers in five regions of the country: east, west, south, north and central China. Users can request after-sales services online and send their devices to a repair center for maintenance, receiving our device repair and exchange services without leaving home. We have also promoted SF Express's pay on delivery service, addressing users' concerns about delivery fees.

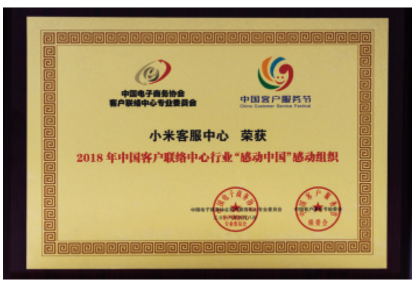
In order to shorten the maintenance time and improve users' service experience, in 2013, Xiaomi took the lead in launching the "one-hour express repair" service.

Customer service is supported by all staff, serving our customers with enthusiasm

Xiaomi has currently established multiple channels to communicate with customers, including Mi Community, Xiaomi official Weibo account, Xiaomi official WeChat account, customer service hotline, online chatting, emails and offline Mi Homes. Wherever the customer is, Xiaomi's customer service will follow.

Xiaomi has been advocating the concept of "customer services should be supported by all staff" since it was a start-up. All managers, even the founder, are involved in addressing customers' requests. Xiaomi is a service oriented company and has created a comprehensive service system, reflecting the importance that the Group places on customer services. Today, Xiaomi has put forward a new service concept of "serving the customers with enthusiasm", to share with everyone the joy and fun of technology. In 2018, the customer complaint handling satisfaction rate was 97.1%, and the overall customer satisfaction rate was 94.51%.

To better meet our customers' needs, we set up 3-in-1 customer service centers that integrate hardware products, software products and e-commerce services.



To cater to different users, customer service staff use different communication styles. Xiaomi believes that as long as we regard customers as friends, there are many ways that we can provide innovative customer services. Even a tiny modification can bring improvements in the value of our service. "Sincerity is the key to excellent service!"

The unwavering efforts of Xiaomi's customer services team have won recognition from both users and the industry. In 2018, Xiaomi's Customer Service Center won major awards in the industry, including the "Touching Organization" from the Touching China 2018 China Customer Communication Center Industry Awards and the "2018 Top Ten Call Center Award".

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Heart-to-heart service experience provided by Mi Home

Mi Home is the direct customer service center established by Xiaomi. Since its establishment, Mi Home has been committed to providing a good and reassuring customer experience.

In recent years, through continuous products and service experience upgrades, Mi Home has been gradually transformed from focusing on product sales and after-sales services to its current focus on product sales and experience. To ensure the quality of service, a service quality management standard and a regular inspection system have been formulated in Mi Homes.

In the Mi Home showroom, nearly all new products are presented for consumers to try out. In order to meet users' purchasing needs, Mi Home optimized the product portfolio to fit users' shopping habits, and to help users make better choices. In addition, Mi Home's mobile POS payment system enables customers to check out anywhere in the store, or with any staff at the location, sparing customers the hassle of queuing.

As of the end of 2018, the number of Mi Homes in mainland China reached 586, and the number of Xiaomi authorized stores in mainland China reached 1,378. At the same time, Mi Home is also popular among customers globally.

Bangalore Mi Home: the largest Mi Home in India

The first Mi Home in Barcelona

5.3 Xiaomi is supported by Mi Fans

Good companies make profit, great companies also win over people's hearts. During the eight years of business since Xiaomi's foundation, we are proud of not only the achievements of our innovation and business made, but also the "fan culture" that we built. We have an enormous number of enthusiastic users known as "Mi Fans" all over the world, and they are part of the Xiaomi family.

Footprint of Mi Fans

2010	When developing our first product the MIUI system, Xiaomi selected the 100 tech enthusiasts on Mi Forum to exchange their views on research and development of the operating system with engineers. They are those called "100 Dream Sponsors" of Xiaomi.
2011	In August, Mi Community was launched and quickly became the base camp for Mi Fans. On December 31 of the same year, the first annual Mi Pop event was held.
2012	On April 6, the first Mi Fans festival was held in Beijing 798 Art Park and became an important festival for Mi Fans. On November 12 the number of registered Mi Fans in Mi Community exceeded 5 million. On December 29 the second annual Mi Pop event was held.
2013	The official Mi Pop event was held 18 times. It was held outside mainland China for the first time in Taiwan. At the end of year, the number of registered Mi Fans in Mi Community exceeded 30 million.
2014	Xiaomi's Mi Pop went outside China for the first time and was successfully held in Singapore. The Xiaomi fan club was also established overseas.
2015	The largest fan club event in the history of Xiaomi, Xiaomi 4i Hundreds Cities Tasting Party, was held. In July, Mi Fans were organized to participate in the Zhengzhou Aviation Show. In December, the first Xiaomi family feast was held in the Xiaomi headquarters canteen.
2016	The Mi Fans offline activities were upgraded. Various events were organized including Mi Orange Run events advocating the concept of healthy living, Mi Black Technology Party events to experience the cutting-edge technologies, Mi Pop events jointly held with the opening of Mi Home, and a campaign initiated by Xiaomi staff to reward Mi Fans with 100 thousand hand-written postcards. The number of registered members in Mi Community reached 70 million.
2017	Xiaomi fan club covered 80 cities. Xiaomi campus fan club covered 300 colleges and universities.
2018	Over 600 activities were held by the Xiaomi fan club, and over 520 by the Xiaomi campus fan club. The number of registered members in Mi Community exceeded 130 million.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Mi Community

Mi Community is the main online channel for communication between Xiaomi and Mi Fans, Mi Community, coupled with Xiaomi's official social media on Weibo and Wechat, is committed to creating an open and interactive environment for users. In 2018, the number of registered users in Mi Community exceeded 130 million.

Every month, Mi Community plans and organizes interactive activities among Mi Fans, which cover different themes, e.g. mobile phone evaluation contests, smart home forum, and "letter from Xiaomi" activities. Mi Community is a key channel for us to obtain feedback, views, and ideas from users on our products. Our customer service and product managers also address questions from users in Mi Community.

Xiaomi staff wrote 100 thousand postcards to Mi Fans.

Mi Pop

"Mi Pop" includes dozens of meetings organized by Xiaomi every year, more than 500 fan club events organized by users and the "Annual Mi Pop Festival" at the end of each year. Users can participate in the whole process of preparing these activities. The venues, performance and performers are all selected from the forums. The venues are arranged by Mi Fans volunteers. Dinners are organized so that local representative Mi Fans and the Xiaomi team can have further discussions after each "Mi Pop" event.

Mi Orange Run

Mi Orange Run is committed to the promotion of healthy living and environmental protection. It aims to involve more young people in a fun environment to exercise, interact, and share the joy of technology while paying attention to environmental protection. Mi Orange Run has toured more than ten cities across China, with 500–1000 Mi Fans participating in each event.

In addition, Mi Fans have spontaneously organized 93 fan clubs so far, covering almost all first- and second- tier cities in China. "Mi Campus Club" which is organized by student Mi Fans, covered more than 485 colleges and universities as of the end of 2018.

Through both online and offline interactive events, Xiaomi hopes to provide users with a platform to profile themselves and meet with new friends, so that every Mi Fans can be a "star".

5.4 Technologies accessible to everyone

Xiaomi believes everyone has the right to full information accessibility and any individual is fully entitled to use all functions that can be provided by technology and obtain complete information. According to the statistics released by the China Disabled Persons' Federation, the total number of disabled people in mainland China reached more than 85 million. In today's era of information explosion, there is an "invisible high wall" faced by this population. The value of information accessibility is to breakdown information barriers and narrow any digital divide. Xiaomi has conducted a significant amount of work in various aspects of information accessibility, including conducting research and development of accessible functionality, actively participating in the establishment of standards for accessibility, and promoting public awareness of the importance of accessibility.

Research and development of MIUI accessible functions

MIUI is the operating system of Xiaomi smartphones, and also the first product of Xiaomi. We have launched 10 major versions of MIUI. Starting from MIUI8, we have developed well-established and standardized processes for the development of accessible functions. Xiaomi has been at the forefront of mobile internet and artificial intelligence, focusing on innovation, development and transformation. Xiaomi calls on all engineers to focus on information accessibility as a priority and has set up a special task force to conduct rigorous evaluation of progress in this field.

The brand new MIUI10 has brought in a more pleasant, visual and auditory users' experience, with the following accessibility features:

- Talkback, which is a screen reader built into Android devices that provides users with voice feedback to enable those with visual impairment to use our smartphones. Xiaomi also added a voice tag to all key buttons.
- MIUI10 is the only Android system in China that has camera face recognition with voice prompt to assist visually impaired users..
- MIUI10 is also the only Android system in China that developed an universal remote control with voice prompt functionality.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Active participation in setting accessibility standards

Xiaomi has actively participated in setting national standards for information accessibility. At present, three industry standards, namely *General Design Specification on Web Information Accessibility (web 信息無障礙通用設計規範)*, *Technical Requirements for Mobile Terminal Accessibility(移動終端無障礙技術要求)*, and *Mobile Terminal Accessibility Test Method (移動終端無障礙測試方法)*, have been set, and Xiaomi has actively participated in the process of drafting and revising these standards.

On December 21, 2017, the inaugural meeting of the Information Accessibility Committee of China Internet Society (中國互聯網協會信息無障礙工作委員會) was held in Beijing. Hong Feng, co-founder and senior vice president of Xiaomi, was elected as the deputy director of the Information Accessibility Committee. Xiaomi was one of the co-founder member units of the Information Accessibility Committee.

Raising awareness on information accessibility

Xiaomi understands that it is not possible to single-handedly create an environment with equal access for people with disabilities. We anticipate that it is critical to further collaborate with various partners that have common goals and interests in this field.

On December 3, 2018, China-based UN agencies of UNESCO, UNDP and other organizations in China held the 27th anniversary event of the "International Day of Persons with Disabilities". The theme was "Empowering persons with disabilities and ensuring inclusiveness and equality". Various representatives from governments, academia, media, NGOs and enterprises had participated in the event. Li Weixing, the general manager of the Internet Department IV of Xiaomi, gave a keynote speech on how Xiaomi uses "user-participated development model of Internet" in building information accessibility. Xiaomi has adopted "barrier-free" accessibility as the default standard for its products, and has expressed willingness to share its experience in the development of accessibility of smart phones and Internet with global technology companies. Xiaomi aims to speed up and strengthen development in information accessibility to benefit society, which is in line with the concept of "inclusiveness, fairness and sustainability" advocated by the *UN 2030 Agenda for Sustainable Development* and is highly recognized by UNESCO.

On May 20, 2018, Xiaomi released a promotional video for Mother's Day and 20 May National Day for Helping People with Disabilities (520 助殘日) — a story of mothers with visual disabilities taking pictures of their children. It aims to change the stereotypes of visually impaired persons: besides building a barrier-free physical environment, more efforts are needed to promote a barrier-free awareness that is fair, friendly and inclusive.

In early August 2018, Xiaomi donated 21 sets of Mi 8 mobile phones to the "Yoren Foundation (有人基金會)" for the "Golden Cane (金盲杖)" summer camp of visually impaired students. The summer camp was set up for college-bound students with visual impairments to experience real-life learning and living at university. It was intended to prepare students with the skills needed for college life.

On September 21, 2018, Xiaomi organized a community benefit project "From Impossible to Different" for 8 of its management trainees to spend a day living with 8 selected visually impaired Xiaomi-users. Using props, these management trainees' visual ability was adjusted to that of the selected Xiaomi-users. By living together for that day, they were able to experience what it was like to be living with visual impairment. This activity aims to raise their awareness on "barrier-free" and a deeper understanding of the "each and everyone" set forward in Xiaomi's mission and of their lives.

In March 2019, Lei Jun attracted great attention when he, as a representative of the National People's Congress, submitted the *Proposal on Further Consolidation and Implementation for the development of "Barrier-free" Information Accessibility* (關於進一步深化落實信息無障礙建設的建議) to the National People's Congress. Mr. Li Qingzhong, a member of the National Committee of the Chinese People's Political Consultative Conference and Chairman of the China Association of the Blind, was among the leaders of the information accessibility industry who acknowledged Lei Jun's proposals and expressed their expectations for constructing a comprehensive barrier-free environment in the Internet and information technology industry.

Xiaomi's active promotion of information accessibility comes from the Company's mission: "let everyone in the world enjoy a better life through innovative technology". Xiaomi believes that the benefits brought by technological innovation and progress should be shared by the public in a simple way. The essence of the Internet is transparency, efficiency, equality, and the greatest equality is the equality experienced in daily living: for everyone, regardless of colors, beliefs, origins and education, to enjoy a good life brought by technology.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

6. Gift Freshness to Environment

Xiaomi attaches great importance to environmental protection and conservation, and continuously addresses the impacts of its business operations on the environment. Xiaomi strictly complies with the environmental protection laws and regulations such as the *Environmental Protection Law of the People's Republic of China* (中華人民共和國環境保護法) and the *Energy Conservation Law of the People's Republic of China* (中華人民共和國節約能源法). It advocates and embraces green operation as a core value throughout its product life cycle to make best use of resources and manage emissions.

6.1 Green operation and management

Xiaomi attaches great importance to resource efficiency. We use green energy-saving equipment in our offices and cultivate employees' energy-saving behaviors in many aspects. We post tips such as "turn off the lights" and "save water" in eye-catching areas of the offices. At the same time, we actively promote"paperless" office and encourage employees to re-use paper and print on both sides. In 2018, Xiaomi consumed about 2,306,590 sheets of paper for doubled-sided printing, saving about 1,153,220 sheets of paper in printings. We advocate green travel. In addition, we collect office waste centrally to reduce the number of trash bins used. It is estimated that 8 million disposable plastic bags are saved from reducing the number of trash bins used throughout the year.

In addition, Xiaomi has actively promoted recycling of used equipment. We encourage donating, internal purchasing and recycling out-dated equipment. In 2018, 397 old devices were purchased by employees, and 810 devices were recycled. In addition, certain old devices such as mainframes, monitors, and laptops were donated to schools in poverty stricken areas.

6.2 Green data center

Xiaomi strives to make its data centers more environmental friendly and efficient. Among others, energy-saving is one of the key performance indicators.

Xiaomi uses colocation facilities. When selecting colocation facilities providers, Xiaomi evaluates third party's performance in respect of their adequacy and effectiveness of energy-saving measures. We require third party service providers to put in place a proper air conditioning and ventilation system that maintains constant temperature and humidity for the data center, ensuring operational effectiveness and energy efficiency while enhancing the PUE value of the system room.

Xiaomi also has strict selection criteria for purchasing servers. We select servers with high power efficiency and energy saving capability, as well as a platinum grade consumption conversion rate.

6.3 Green product designs

Energy-conservative designs

Power conservation is not only a key product feature demand by users, but also a key aspect of green products. Starting from energy-saving design, Xiaomi continuously optimizes products' energy-saving performance at both the product definition and system design level.

(1) Ultra Power-saving Mode: Through synchronized process and limiting back-end activities, the system's battery consumption can be further reduced.

(2) All Interface Dark Mode: MIUI provides users with All Interface Dark Mode that presents the system interface in black to significantly reduce battery consumption. At the same time, in a dim indoor environment or at night, the black interface can provide users with a more comfortable reading experience.

(3) Xiaomi adopts a philosophy of energy efficiency. By reducing the CPU power and strictly controlling the selection of sensors, the battery duration of Xiaomi wristband has been extended to more than one month, which outperforms similar products in energy-saving.

Packaging Minimization

Simplicity has always been adopted in the package design of Xiaomi's products to avoid over-packaging. In 2018, Xiaomi set up package design guidance to achieve standardized management of the environmental-friendly aspects of product packaging. This guidance has helped achieve not only a reduction in the consumption of packaging materials, but also improved efficiency in transportation, thereby reducing energy consumption and emissions in the course of transportation.

In terms of structural design, the minimized efficient packaging of Xiaomi smartphones is applied to more than 95% of mobile phone products and the utilization rate of packaging space is 70%-85%, thus minimizing the use of packaging materials.

In material selection, most ecosystem products are packaged with paper based materials. Among them, medium-sized and small-sized products will not be packaged with EPS[2] buffer materials, and the use of non-green materials such as PET, PP, PS[3], and processes involving blister and injection are reduced. For packaging of large-sized products, the packaging structure design is optimized so that materials such as paper and paper pulp are used instead of EPS, EVA[4] and EPE[5], thereby reducing the impact on the environment. As for logistics packaging, Xiaomi is actively exploring new green logistics models, promoting the application of logistics turnover boxes in Xiaomi warehouses, and advancing resource-intensive and reusable logistics packaging. In terms of parcel packaging, we have integrated a number of courier boxes with different specifications that have greatly improved the use of parcel packaging.

We have adopted kraft linerboard which is made up of 71% waste paper pulp, 18% wood pulp, 8% water and 3% fillers. Buffer materials and gray board made of waste paper pulp are 100% recycled and degradable, so they are environmentally friendly. The packaging printing ink is made of soy so it is not harmful to humans or the environment.

1 EPS, Expanded Polystyrene and polystyrene foam, one of the white pollutants, cannot enter the biogeochemical cycle via biodegradation and photolysis.
2 PET, Polyethylene terephthalate; PP, Polypropylene; PS, Polystyrene.
3 EVA, Ethylene Vinyl Acetate Copolymer.
4 EPE, Expandable Polyethylene.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Table of environmental key performance indicators

Unless otherwise specified, environmental key performance indicators cover the Group's main offices and self-operated Mi Homes in mainland China.

1. *Emissions*

Total GHG emissions (scopes 1 and 2) (tons)	**13,093.57**
Direct GHG emissions (scope 1) (tons)	271.69
Indirect GHG emissions (scope 2) (tons)	12,821.88
Total GHG emissions in the office buildings per floor area (tons per square metre)	**0.09**
Hazardous waste (tons)	**1.16**
Hazardous waste per employee (tons per employee)	**0.000097**
Non-hazardous waste (tons)	**1,027.17**
Non-hazardous waste per employee (tons per employee)	**0.09**

1. Due to its business nature, the significant air emissions of the Group are GHG emissions, arising mainly from natural gas and electricity derived from fossil fuels.
2. The Group's GHG inventory includes carbon dioxide, methane and nitrous oxide. GHG emissions data is presented in carbon dioxide equivalent and is based on the "2015 Baseline Emission Factors for Regional Power Grids in China" issued by the National Development and Reform Commission of China, and the "2006 IPCC Guidelines for National Greenhouse Gas Inventories" issued by the Intergovernmental Panel on Climate Change (IPCC).
3. GHG emissions (Scope 1) arise mainly from the consumption of "direct energy" (natural gas). GHG emissions (Scope 2) arise mainly from the consumption of "indirect energy" (purchased electricity).
4. Hazardous waste produced by the Group's operation mainly includes waste toner cartridges, waste ink cartridges from office printing equipment, waste fluorescent tubes and waste lead-acid accumulators. Waste toner cartridges and waste ink cartridges are collected and disposed of by printing suppliers, whereas waste fluorescent tubes and waste lead-acid accumulators are disposed of by qualified waste recycling vendors.
5. Non-hazardous waste produced by the Group's operation mainly includes office waste and domestic waste, which are disposed by the property management company.

2. *Energy and resources consumption*

Total energy consumption (MWh)	**18,856.92**
Direct energy consumption (MWh)	1,389.45
Indirect energy consumption (MWh)	17,467.47
Total energy consumption per employee (MWh per employee)	**1.32**
Running water consumption (tons)	**81,345.33**
Running water consumption per employee (tons per employee)	**6.77**
Total packaging material used for finished products(tons)	**65,281.37**
Total packaging material used for finished products per RMB million in revenue(tons/RMB million)	**0.37**

1 Energy consumption is calculated using electricity and natural gas data with reference to the coefficients in the National Standards of the People's Republic of China "General Principles for Calculation of the Comprehensive Energy Consumption (GB/T 2589-2008)".

2 Direct energy consumption is the consumption of natural gas during the Group's operation. Indirect energy consumption is the consumption of electricity during the Group's operation.

3 The Group's water resources consumed come from the municipal water supply.

4 Total packaging material used for finished products is the total amount of packaging materials used for smartphones, smart TVs and major products of ecosystem products.

6.4 Green supply chain

As the core enterprise of the supply value chain, Xiaomi aims to fulfil its social responsibility. We hope to work together with all partners to promote a green supply chain and to jointly establish a sustainable development model.

In 2018, Xiaomi designated personnel to carry out the management of supplier's CSR performance. In addition, in accordance with the *Responsible Business Alliance Code of Conduct (RBA責任商業聯盟行為準則)*, *Supply Chain Sustainability Guideline Governing Telecom Industry (電信行業供應鏈可持續指南)*, including standards SA8000, ISO14001, ISO45001 and based on Xiaomi's supplier CSR key risks identification, Xiaomi set up its *Supplier Social Responsibility Code of Conduct (供應商社會責任行為準則)* and *Supplier Social Responsibility Agreement (供應商社會責任協議)*, stipulating management requirements for its suppliers in 13 aspects such as business ethics, child labor protection, environment management and labor rights.

Moreover, in order to encourage suppliers to effectively implement CSR practices, Xiaomi conducted online questionnaire assessment and offline field surveys to form an in-depth understanding of suppliers' CSR performance. In 2018, over 100 core suppliers took part in online assessments and offline research.

At the 2018 Xiaomi Core Supplier Conference, Xiaomi conveyed to more than 200 core suppliers the concept of "promoting a green supply chain and shouldering social responsibilities". Xiaomi will set up a work plan to promote the signing of the Supplier Social Responsibility Agreement. This involves setting up a supply chain CSR management working group, a CSR risk database, and conducting supplier CSR audits, follow-up audits and exchanges, etc.. Xiaomi will consistently improve CSR in our supply chain and promote the development of a green supply chain.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

7. Gift Happiness to Everyone

Xiaomi is committed to making everyone enjoy their life through technology. We aim to promote happiness to all, contribute to society and utilize the latest technology to improve the lives of many.

7.1 Enthusiastic Xiaomi employees

In 2010, the co-founders of Xiaomi founded the company with limited resources. At the 2018 Anniversary Staff Activity, Lei Jun said "experienced employees are very precious assets to Xiaomi. The experienced employees carry the heritage of our culture while new employees are the hope of our future. Thank you, my fellow friends, for your tears, laughter and effort along the way! Our sincerity and love for this will remain the same regardless of time."

We want every Xiaomi employee to have sincerity and passion. Xiaomi cherishes every employee. We strive to create a comfortable and harmonious working environment, protect the health and safety of our employees, actively organize employee trainings, boost employee development, and regard employees' rights and benefits as the starting point of "gifting happiness to everyone".

Recruitment and employment

In strict accordance with the *Labor Law of the People's Republic of China* (*《中華人民共和國勞動法》*), the *Labor Contract Law of the People's Republic of China* (*《中華人民共和國勞動合同法》*), the *Special Rules on the Labor Protection of Female Employees* (*《女職工勞動保護特別規定》*) and other laws and regulations, Xiaomi issues policies to standardize the management of recruitment, employment, dismissal, salary and benefits, attendance, rest period, equal opportunity, anti-discrimination and diversity.

Xiaomi complies with the principle of fair competition and meritocracy. Existing and prospective employees share equal opportunities. In recruitment and salary setting, Xiaomi treats each job applicant and employee equally irrespective of his or her nationality, race, age, gender, marital status, religious belief, etc. Xiaomi signs labor contracts with employees based on the principle of equality, free will, consensus and integrity. We abide by the *Special Rules on Labor Protection of Female Employees* (*《女職工勞動保護特別規定》*), and safeguard female employees' rights and benefits in pregnancy, perinatal period and lactation. Salary reduction or dismissal with no reason during the above mentioned periods is prohibited. Xiaomi greatly respects every employee's dignity and personality. Furthermore, Xiaomi forbids any form of insults and discrimination, and strictly prohibits menacing, insulting or exploitative behavior and child labor.

Employee diversity

As of the end of 2018, Xiaomi had 16,000 employees from 44 countries. They work in over 30 countries. Xiaomi treats every employee equally and strictly complies with relevant laws from different jurisdictions and follows international conventions on recruitment, employment, salary and benefits, attendance, rest period and other various aspects.

Xiaomi has an energetic and proactive team. Our team consists of experienced professionals as well as young talents with ambitions, ideals, courage and accountability. The average age of employees in Xiaomi is 29.1 years old, of whom 65% are aged 30 or below. Xiaomi will develop and promote young talents to embrace our culture, enrich our talent pool, accelerate organization development and enhance operating efficiency.

Health and safety

A safe, healthy and comfortable working environment underpins Xiaomi's sustainable development. In strict compliance with the *Production Safety Law of the People's Republic of China* (*《中華人民共和國安全生產法》*), the *Prevention and Control Law of Occupational Diseases of the People's Republic of China* (*《中華人民共和國職業病防治法》*), the *Provisions on the Supervision and Administration of Occupational Health at Work Sites* (*《工作場所職業衛生監督管理辦法》*) and other national and regional laws and regulations and industry standards, Xiaomi established a series of work process and policies to ensure personal and property safety.

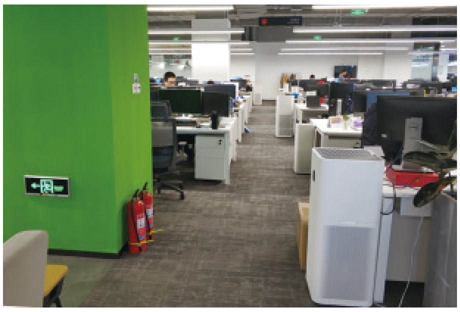
Well-established systems for employee benefits

In addition to social insurance and welfares prescribed by regulations, Xiaomi provides supplementary commercial insurances (medical insurance/accident insurance, etc.) to employees. Additional commercial insurance plans are available for other family members to purchase. Xiaomi also arranges annual health check for employees and holds health talks and activities from time to time. Also, we provide additional insurances for employees participating in the Company's activities like "Xiaomi Football Super League" and "Xiaomi Outdoor".

Safe and relaxing environment

Xiaomi cares about the physical and mental health of the employees, as well as their working environment. With well-developed security and fire systems, tea rooms, relaxation areas and other facilities in office, we strive to create a safe and relaxing environment for our employees.

Moreover, there are internal online platform, complaint box, labor community and Wechat official account for our employees to provide feedback.



Every 120 square meters area is equipped with an air purifier and every 60 square metres area is equipped with a humidifier.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Development and training

In Xiaomi, everyone is encouraged to proactively express their thoughts and creative ideas. Vast amount of training resources are available for all the employees, including professional training and leadership training.

Xiaomi developed a variety of training projects for different employee groups. For instance, there is Spark Camp for entry level managers, Young "π" for management trainees and Torch Program for middle management. These projects accelerate the integration of new employees into our organization, improve the management ability of managers and cultivate the strategic thinking of talents.

"Mi Xue Hui (米學滙)", a monthly course available to all employees, aiming to enhance personal development, improve professional skills, and promote sustainable development.

"Journey of Love (真愛之旅)", a training project for fresh graduates to help them understand our business practice and culture and adapt to the society.

In order to groom management talent, we have specifically established a management trainee program for Young "π" (少年π), a new generation with infinite possibilities. In order to train this unique new generation to be familiar with the company's business practice and culture and to become the next generation leader, these talents will go through work rotation, working in Mi Homes, opening new physical stores and factories visits, etc.

"Spark Camp (星火集訓營)" helps new managers kick start their management training through study groups, classes and debates. After graduation from the camp, they will understand their responsibilities better and master basic management knowledge and skills, to better transition to and appreciate their role.

The "Monthly Management Theme" (管理主題月) activities provide management with a channel to share their experience, role play various scenarios, voice out difficulties encountered, and give feedback on key management behaviors. At the same time the "Monthly Management Chat" (管理漫月談) offers online management simulation classes. With the help of these online and offline training activities, managers can upgrade their management skills.

The "Torch Program" is tailored by Xiaomi for training middle managers who have been identified as potential candidates for future senior management. Torch represents the spirit of our heritage. During 2017–2018, 134 middle managers participated in the Torch Program, joining various advanced courses, face-to-face meetings with senior executives, study tours and workshops, all designed to enhance their business acumen ,soft skills and leadership capabilities. In 2019, Xiaomi will launch the "Ignition" program, a training program for middle- and senior-level managers, designed to improve strategic guidance, strengthen the organization, and enhance management capabilities.

Work life balance

Xiaomi makes great efforts to provide our hard-working employees a work life balance. Currently, there are more than 14 employee clubs, with more than 500 employees participating annually in each club. Each club holds two events per week for employees with common hobbies and interests. The Xiaomi Cup includes basketball, tug-of-war, badminton, swimming and many other activities for employees to relax.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Xiaomi holds welfare activities two to three times per week. We host the Group annual celebration and Xiaomi Family Day once every year. The Voice of Xiaomi and other festive welfare activities are also held from time to time.

Xiaomi is recognized by the industry for its HR management innovations. Xiaomi won the "Human Resources Management Best Practices Award" (人力資源管理實踐) at the 2018 China Annual Conference for Human Resources Management and China Human Resources Management Academy Award Ceremony (2018第十一屆中國人力資源管理年會暨第八屆中國人力資源管理學院獎頒獎典禮), which was organized by the Renmin University School of Business and the China Human Resources Theory and Practice Alliance.

7.2 Contribute to the society and deliver happiness

Since its founding in 2010, under the leadership of Lei Jun, Xiaomi is committed to charity, including making donations to education charities, care for people with disabilities, environment protection, disaster relief, etc. We fulfill our social responsibilities and send a positive message to society through donations, trainings, charitable sales, employment opportunities for disabled, etc. From 2016 to 2018, Xiaomi donated over RMB100 million (including both the Group donations and Lei Jun's personal donations), Xiaomi also donates books, electronic equipments, food and other materials to address various needs in the community and launched campaigns such as "Entrepreneur Training" to build capabilities in the society. In 2018, Xiaomi took steps to better integrate its charity objectives with community needs, and conducted various charitable activities.

Orange run, green run

Xiaomi noticed that organizers of large events tend to use disposable materials for convenience and leave garbage unsorted, putting great pressure on the environment. As a responsible enterprise, when we started the Orange Run, we made every effort to reduce our carbon footprint on the environment. The Orange Run was held in 10 locations in 2018, including Zhuhai and Kunming, and successfully reduced the amount of garbage that would have been dumped in landfills or incinerated by 90%. We reduced environmental costs through the use of reusable tents, flags and other structures for multiple events. Through these activities, Xiaomi demonstrated that garbage classification and reduction can be easy and effective.

At the same time, we work closely with the agencies responsible for zero-waste activities in different cities. Our activity partners are committed to environmental protection and volunteer work.

The Orange Run produced only 41.26 kilograms of garbage (excluding structures) in 2018, of which 88% was recycled. This activity blends orange with green, and youth with environmentalism.

Targeted poverty alleviation to help persons with disabilities realize the China Dream

The "CSR China Education Award" aims to encourage and reward distinguished CSR projects for education development in China, as well as corporations and organizations that make prominent contributions to the education sector. It is the only official award jointly set up by multiple institutions, with the endorsement of the Communist Youth League Central Committee, the Ministry of Education and the Ministry of Industry and Information Technology. Xiaomi initiated the "Targeted Poverty Alleviation to Help Persons with Disabilities Realize the China Dream" project, which was highly acclaimed by the assessors in 2018.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

With the project of "Targeted Poverty Alleviation for Persons with Disabilities to Realize the China Dream" Xiaomi promotes employment of persons with disabilities and has provided almost 200 persons with disabilities with appropriate jobs from 2017. People with disabilities are eager for jobs, willing to make a better living on their own and keen to realize their personal and social values. However, there are few suitable jobs and related training available for them.

In accordance with corporation needs and business development, Xiaomi has set up suitable opportunities for persons with disabilities with the help of different departments. Occupational trainings and mental health courses are provided to address problems they encounter in work and life, so that they can have positive work experience and deal with challenges.

China Disabled Persons' Federation recognizes our efforts. Lu Yong, the chairman of China Disabled Persons' Federation, hopes that there will be more corporates, just like Xiaomi, joining hands in developing an employment platform to create more job opportunities for persons with disabilities.

Continuous concern and devotion are crucial in implementing CSR. Xiaomi will continue to invest human and material resources in CSR. Xiaomi will give persons with disabilities access to more suitable and skilled jobs, so that persons with disabilities can integrate better in the society and then we together can achieve mutual social and economic benefits.

Book Donation Activity

Since World Reading Day in 2016, Xiaomi Duokan Reading (小米多看閱讀) carried out the activity to support reading in Tibetan areas, hoping that more people can participate in public welfare, and that children can enjoy the pleasure of reading. In recent years, Xiaomi, together with enterprises and people from all walks of life, donated nearly 30,000 books and 1,000 sets of stationery worth RMB1 million. In addition, Xiaomi donated electronic reading devices, enabling children to enjoy the pleasure brought by technology while reading.

The WeiLan Microlibrary is a public welfare project initiated by the "New Citizen Program" charity. The purpose of this project is to bring extracurricular books for migrant children and more books to school libraries. The project operates in schools for migrant workers' children and in rural urban fringe areas. In 2019, Xiaomi cooperated with the New Citizen Program and recruited nearly 200 employee-volunteers in the New Hope School, a school for migrant workers' children, two kilometres away from Xiaomi's office building. Xiaomi initiated a fundraising event and book donations throughout the company, which helps the school to buy new books for the library.

Community capacity building — it's better to teach a person how to fish than to give him a fish

Community capacity building is an essential part of Xiaomi's public welfare activities. We believe that it is better to teach a person how to fish than to give him a fish. This way we can bring genuine, sustainable change to benefit the society.

In 2018, Xiaomi established a partnership with the Beijing Changping Practical Skill Training School for Rural Women. Xiaomi employees volunteered to provide entrepreneurship training to students who want to start their own businesses and share e-commerce skills with them.

Beijing Changping Practical Skill Training School for Rural Women is a non-profit practical skill training school for women in rural and impoverished areas. Female teachers, kindergarten teachers and women from rural areas across the country are able to receive training in practical and professional skills in order to help them become self-reliant and reduce poverty.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

Commitment to public benefit

Since its foundation in 2010, Lei Jun's leadership, Xiaomi has been actively taking numerous approaches to social welfare, such as donations for disaster relief, charity sales, education-related donations, public welfare, employment development and awareness raising in order to fulfill Xiaomi's CSR and create positive energy to society.

As a responsible corporate citizen, Xiaomi never regards its contribution to public welfare as a one-off event. Xiaomi is dedicated to socially responsible and will try its utmost to deliver this commitment.

8. Prospects: Have Faith in a Brighter Future

Thank you for your interest in Xiaomi. Together, I believe we can create a paradigm shift of efficiency in the business world and use technology to improve people's everyday lives. To gift honesty to business, to gift warmth to technology, to gift happiness to everyone, our missions have no boundaries and we have only just began. Please join us on our journey. Always believe.

INDEPENDENT AUDITOR'S REPORT

羅兵咸永道

To the Shareholders of Xiaomi Corporation
(incorporated in the Cayman Islands with limited liability)

Opinion

What we have audited

The consolidated financial statements of Xiaomi Corporation (the "Company") and its subsidiaries (the "Group") set out on pages 169 to 309, which comprise:

- the consolidated balance sheet as of December 31, 2018;
- the consolidated income statement for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as of December 31, 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter identified in our audit is related to the classification and fair value determination for unlisted securities classified as "long-term investments measured at fair value through profit or loss".

Key Audit Matter	How our audit addressed the Key Audit Matter
The classification and fair value determination for unlisted securities classified as "long-term investments measured at fair value through profit or loss" Refer to Note 3.3 and Note 19 to the consolidated financial statements. During the year ended December 31, 2018, the Group recognized fair value changes on the following investments in profits or losses: (i) equity investments in unlisted companies other than those accounted for using equity method, and (ii) convertible redeemable preferred shares or ordinary shares with preferential rights investments in unlisted companies (collectively the "Unlisted Securities"), amounting to RMB2,414,031,000 and RMB11,006,279,000, respectively. The total amount of Unlisted Securities as of December 31, 2018 was RMB13,420,310,000, accounting for 9% of the Group's total assets.	We understood and evaluated the key controls over the capturing, measurement and recording of the Unlisted Securities investments. For the classification and initial recognition of the Unlisted Securities, we have performed the following procedures: (1) We checked relevant legal documents such as shareholder agreements, share purchase agreements and articles of association of the investees on a sample basis to understand and evaluate the commercial reasonableness of these Unlisted Securities investments; (2) We evaluated management's analysis on contract terms and assessed the reasonableness of management's accounting treatments on a sample basis.

INDEPENDENT AUDITOR'S REPORT

Key Audit Matter	How our audit addressed the Key Audit Matter
The classification and initial recognition of the Unlisted Securities require management to analyze certain complex contract terms and make judgments to determine the classifications of the above financial assets, based on the Group's business models of managing these financial assets and the contractual terms of the cash flows. The Group identified its various rights and evaluated the financial impacts based on key terms from relevant legal documents. Management engaged an external valuer to assist to determine the year-end fair value of these Unlisted Securities. The fair value determination of such Unlisted Securities required management to make judgments and estimates, including the appropriateness of using various unobservable inputs. We focused on this area due to the significance of the balances of these investments and their related fair value gain or loss for the year, as well as management judgments, assumptions and estimations involved in the initial recognition and fair value determination of the Unlisted Securities.	For the assessment of fair value determination of the Unlisted Securities, we involved our internal valuation specialists to perform the following procedures: (1) We assessed the objectivity, independence and competence of the external valuer engaged by the Group; (2) We interviewed management and understood the underlying assumptions and inputs used in fair value determination of Unlisted Securities; (3) We assessed the reasonableness of assumptions and inputs used in fair value determination of Unlisted Securities, including expected volatility, risk-free interest rate, discounted for lack of marketability; (4) We recalculated the fair values of Unlisted Securities on a sample basis; and (5) We tested the accuracy of the fair value changes on investments measured at fair value through profit or loss for the year on a sample basis. We found the judgments, assumptions and estimations made by management in relation to the initial recognition and fair value determination of the Unlisted Securities to be supportable based on the available evidences.

INDEPENDENT AUDITOR'S REPORT

Other Information

The directors of the Company are responsible for the other information. The other information comprises all of the information included in the annual report other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and the Audit Committee for the Consolidated Financial Statements

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The audit committee are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level

INDEPENDENT AUDITOR'S REPORT

of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

INDEPENDENT AUDITOR'S REPORT

We communicate with the audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Leung Wai Kin.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, March 19, 2019

CONSOLIDATED INCOME STATEMENT

For the year ended December 31, 2018

(Expressed in Renminbi ("RMB"))

	Note	Year ended December 31, 2018 RMB'000	2017 RMB'000
Revenue	6	174,915,425	114,624,742
Cost of sales	9	(152,723,486)	(99,470,537)
Gross profit		22,191,939	15,154,205
Selling and marketing expenses	9	(7,993,072)	(5,231,540)
Administrative expenses	9	(12,099,078)	(1,216,110)
Research and development expenses	9	(5,776,826)	(3,151,401)
Fair value changes on investments measured at fair value through profit or loss	19(iv)	4,430,359	6,371,098
Share of losses of investments accounted for using the equity method	12(b)	(614,920)	(231,496)
Other income	7	844,789	448,671
Other gains, net	8	213,281	72,040
Operating profit		1,196,472	12,215,467
Finance income, net	11	216,373	26,784
Fair value changes of convertible redeemable preferred shares	35	12,514,279	(54,071,603)
Profit/(loss) before income tax		13,927,124	(41,829,352)
Income tax expenses	13	(449,377)	(2,059,763)
Profit/(loss) for the year		13,477,747	(43,889,115)
Attributable to:			
— Owners of the Company		13,553,886	(43,826,016)
— Non-controlling interests		(76,139)	(63,099)
		13,477,747	(43,889,115)
Earnings/(loss) per share (expressed in RMB per share):	14		
Basic		0.843	(4.491)
Diluted		0.044	(4.491)

The notes on pages 177 to 309 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31, 2018

(Expressed in RMB)

	Note	Year ended December 31, 2018 RMB'000	2017 RMB'000
Profit/(loss) for the year		**13,477,747**	(43,889,115)
Other comprehensive (loss)/income:			
Items that may be reclassified subsequently to profit or loss			
Share of other comprehensive income/(loss) of investments accounted for using the equity method	12(b)	**191,449**	(22,783)
Currency translation differences		**(648,746)**	(137,124)
Item that will not be reclassified subsequently to profit or loss			
Currency translation differences		**(1,098,818)**	8,054,273
Other comprehensive (loss)/income for the year, net of tax		**(1,556,115)**	7,894,366
Total comprehensive income/(loss) for the year		**11,921,632**	(35,994,749)
Attributable to:			
— Owners of the Company		**11,989,243**	(35,922,124)
— Non-controlling interests		**(67,611)**	(72,625)
		11,921,632	(35,994,749)

The notes on pages 177 to 309 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As of December 31, 2018

(Expressed in RMB)

	Note	As of December 31, 2018 RMB'000	2017 RMB'000
Assets			
Non-current assets			
Land use rights	15	**3,402,968**	3,416,359
Property and equipment	16	**5,068,053**	1,730,872
Intangible assets	17	**2,061,192**	2,274,352
Investments accounted for using the equity method	12(b)	**8,639,238**	1,710,819
Long-term investments measured at fair value through profit or loss	19	**18,636,208**	18,856,961
Deferred income tax assets	34	**1,312,245**	591,576
Other non-current assets		**95,485**	150,361
		39,215,389	28,731,300
Current assets			
Inventories	23	**29,480,685**	16,342,928
Trade receivables	21	**5,598,443**	5,469,507
Loan receivables	20	**10,293,645**	8,144,493
Prepayments and other receivables	22	**20,914,946**	11,393,910
Short-term investments measured at amortized cost	19	**—**	800,000
Short-term investments measured at fair value through profit or loss	19	**6,648,526**	4,488,076
Short-term bank deposits	24(c)	**1,365,991**	225,146
Restricted cash	24(b)	**1,480,178**	2,711,119
Cash and cash equivalents	24(a)	**30,230,147**	11,563,282
		106,012,561	61,138,461
Total assets		**145,227,950**	89,869,761
Equity and liabilities			
Equity attributable to owners of the Company			
Share capital	25	**377**	150
Reserves		**71,322,608**	(127,272,511)
		71,322,985	(127,272,361)
Non-controlling interests		**(72,856)**	61,670
Total equity		**71,250,129**	(127,210,691)

CONSOLIDATED BALANCE SHEET

As of December 31, 2018

(Expressed in RMB)

	Note	As of December 31, 2018 RMB'000	2017 RMB'000
Liabilities			
Non-current liabilities			
Borrowings	33	7,856,143	7,251,312
Deferred income tax liabilities	34	777,645	1,018,651
Warranty provision		559,016	191,404
Convertible redeemable preferred shares	35	—	161,451,203
Other non-current liabilities	29	2,844,859	35,211
		12,037,663	169,947,781
Current liabilities			
Trade payables	30	46,287,271	34,003,331
Other payables and accruals	31	6,312,770	4,223,979
Advance from customers	32	4,479,522	3,390,650
Borrowings	33	3,075,194	3,550,801
Income tax liabilities		661,816	421,113
Warranty provision		1,123,585	1,542,797
		61,940,158	47,132,671
Total liabilities		73,977,821	217,080,452
Total equity and liabilities		145,227,950	89,869,761

The notes on pages 177 to 309 are an integral part of these consolidated financial statements.

The consolidated financial statements on pages 169 to 309 were approved by the Board of Directors on March 19, 2019 and were signed on its behalf:

Lei Jun
Director

Lin Bin
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended December 31, 2018

(Expressed in RMB)

	Note	Attributable to owners of the Company						
		Share capital RMB'000	Share premium RMB'000	Other reserves RMB'000	(Accumulated losses)/retained earnings RMB'000	Sub-total RMB'000	Non-controlling interests RMB'000	Total Equity RMB'000
Balance at January 1, 2018		150	742,760	947,420	(128,962,691)	(127,272,361)	61,670	(127,210,691)
Comprehensive income								
Profit for the year		—	—	—	13,553,886	13,553,886	(76,139)	13,477,747
Other comprehensive income								
Items that may be reclassified subsequently to profit or loss								
Share of other comprehensive income of investments accounted for using the equity method	12(b)	—	—	191,449	—	191,449	—	191,449
Currency translation differences	26	—	—	(657,274)	—	(657,274)	8,528	(648,746)
Item that will not be reclassified subsequently to profit or loss								
Currency translation differences	26	—	—	(1,098,818)	—	(1,098,818)	—	(1,098,818)
Total comprehensive income		—	—	(1,564,643)	13,553,886	11,989,243	(67,611)	11,921,632
Transactions with owners in their capacity as owners								
Issuance of ordinary shares	25	11	9,827,146	—	—	9,827,157	—	9,827,157
Issuance of ordinary shares relating to initial public offering, net of underwriting commissions and other issuance costs	25	27	23,248,593	—	—	23,248,620	—	23,248,620
Release of ordinary shares from Share Scheme Trusts	25	15	933,592	(841,640)	—	91,967	—	91,967
Conversion of convertible redeemable preferred shares to ordinary shares	35	174	151,100,334	—	—	151,100,508	—	151,100,508
Share of other reserves of investments accounted for using the equity method	12(b)	—	—	62,657	—	62,657	—	62,657
Employees share-based compensation scheme:								
— value of employee services	28	—	—	2,358,720	—	2,358,720	102,805	2,461,525
Acquisition of additional equity interests in non-wholly owned subsidiaries	12(a)	—	230,899	(152,071)	(162,046)	(83,218)	(171,220)	(254,438)
Appropriation to statutory reserves	26	—	—	57,808	(57,808)	—	—	—
Share premium set off the accumulated losses and other reserves	25	—	(142,232,042)	5,579,472	136,652,570	—	—	—
Others		—	—	(308)	—	(308)	1,500	1,192
Total transactions with owners in their capacity as owners		227	43,108,522	7,064,638	136,432,716	186,606,103	(66,915)	186,539,188
Balance at December 31, 2018		377	43,851,282	6,447,415	21,023,911	71,322,985	(72,856)	71,250,129

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended December 31, 2018

(Expressed in RMB)

		Attributable to owners of the Company						
	Note	Share capital RMB'000	Share premium RMB'000	Other reserves RMB'000	Accumulated losses RMB'000	Sub-total RMB'000	Non-controlling interests RMB'000	Total Equity RMB'000
Balance at January 1, 2017		150	742,760	(8,124,355)	(84,810,225)	(92,191,670)	133,795	(92,057,875)
Comprehensive loss								
Loss for the year		–	–	–	(43,826,016)	(43,826,016)	(63,099)	(43,889,115)
Other comprehensive income								
Items that may be reclassified subsequently to profit or loss								
Share of other comprehensive loss of investments accounted for using the equity method	12(b)	–	–	(22,783)	–	(22,783)	–	(22,783)
Currency translation differences	26	–	–	(127,598)	–	(127,598)	(9,526)	(137,124)
Item that will not be reclassified subsequently to profit or loss								
Currency translation differences	26	–	–	8,054,273	–	8,054,273	–	8,054,273
Total comprehensive loss		–	–	7,903,892	(43,826,016)	(35,922,124)	(72,625)	(35,994,749)
Transactions with owners in their capacity as owners								
Share of other reserves of investments accounted for using the equity method	12(b)	–	–	33,539	–	33,539	–	33,539
Employees share-based compensation scheme:								
– value of employee services	28	–	–	807,894	–	807,894	–	807,894
Appropriation to statutory reserves	26	–	–	326,450	(326,450)	–	–	–
Others		–	–	–	–	–	500	500
Total transactions with owners in their capacity as owners		–	–	1,167,883	(326,450)	841,433	500	841,933
Balance at December 31, 2017		150	742,760	947,420	(128,962,691)	(127,272,361)	61,670	(127,210,691)

The notes on pages 177 to 309 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31, 2018

(Expressed in RMB)

	Note	Year ended December 31, 2018 RMB'000	2017 RMB'000
Cash flows from operating activities			
Cash generated from operations	36(a)	122,171	527,321
Income tax paid		(1,536,742)	(1,522,990)
Net cash used in operating activities		(1,414,571)	(995,669)
Cash flows from investing activities			
Capital expenditures		(3,785,259)	(1,217,806)
Proceeds from disposal of property and equipment	36(b)	27,367	1,531
Placement of short-term bank deposits		(2,060,799)	(255,262)
Withdrawal of short-term bank deposits		903,504	448,690
Purchase of short-term investments measured at fair value through profit or loss		(140,955,400)	(104,284,000)
Receipt from maturity of short-term investments measured at fair value through profit or loss		139,154,171	103,254,537
Purchase of short-term investments measured at amortized cost		(3,500,000)	(10,641,000)
Receipt from maturity of short-term investments measured at amortized cost		4,300,000	9,921,000
Interest income received		489,816	266,054
Investment income received		335,695	162,702
Purchase of long-term investments measured at fair value through profit or loss		(1,999,752)	(813,175)
Proceeds from disposal of long-term investments measured at fair value through profit or loss		304,999	494,018
Purchase of investments accounted for using the equity method		(793,595)	(156,551)
Disposal of a subsidiary		(25,655)	—
Acquisition of a subsidiary, net of cash acquired		(34,936)	—
Dividends received		131,804	141,548
Net cash used in investing activities		(7,508,040)	(2,677,714)

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31, 2018

(Expressed in RMB)

	Note	Year ended December 31, 2018 RMB'000	2017 RMB'000
Cash flows from financing activities			
Proceeds from issuance of convertible redeemable preferred shares		—	67,573
Proceeds from borrowings		10,269,415	11,174,861
Repayment of borrowings		(10,505,637)	(4,531,248)
Finance expenses paid		(243,966)	(207,384)
Placement of restricted cash		(4,152,345)	(913,202)
Withdrawal of restricted cash		5,059,245	624,330
Payment for acquisition of non-controlling interests in a non-wholly owned subsidiary		(165,000)	—
Proceeds from fund investors		2,781,000	—
Net proceeds from issuance of ordinary shares relating to the initial public offering		23,248,620	—
Proceeds from release of ordinary shares from Share Scheme Trusts		91,967	—
Others		190,873	—
Net cash generated from financing activities		26,574,172	6,214,930
Net increase in cash and cash equivalents		17,651,561	2,541,547
Cash and cash equivalents at the beginning of the year	24(a)	11,563,282	9,230,320
Effects of exchange rate changes on cash and cash equivalents		1,015,304	(208,585)
Cash and cash equivalents at the end of the year	24(a)	30,230,147	11,563,282

The notes on pages 177 to 309 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

1 General information

Xiaomi Corporation (formerly known as Top Elite Limited) (the "**Company**"), was incorporated in the Cayman Islands on January 5, 2010 as an exempted company with limited liability under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The address of the Company's registered office is at the offices of Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.

The Company is an investment holding company. The Company and its subsidiaries, including controlled structured entities (together, the "**Group**") are principally engaged in development and sales of smartphones, internet of things ("**IoT**") and lifestyle products, provision of internet services and investments holding in the People's Republic of China and other countries or regions.

Lei Jun is the ultimate controlling shareholder of the Company as of the date of approval of these consolidated financial statements.

The regulations in mainland China restrict foreign ownership of companies that provide internet services, e-commerce and value-added telecommunications services, etc., which include certain activities and services operated by the Group. In order to enable certain foreign companies to make investments into these businesses of the Group, the Company controls certain subsidiaries through contractual arrangements. On August 25, 2010, a wholly owned subsidiary of the Company, Xiaomi Communications Co., Ltd. ("**Xiaomi Communications**", a wholly foreign-owned enterprise) had entered into a series of contractual arrangements (the "**Contractual Arrangements**") with Xiaomi Inc. and its equity holders, which enable Xiaomi Communications and the Group to:

- govern the financial and operating policies of Xiaomi Inc.;
- exercise equity holders' voting rights of Xiaomi Inc.;
- receive substantially all of the economic interest returns generated by Xiaomi Inc. in consideration for the business support, technical and consulting services provided by Xiaomi Communications;
- obtain an irrevocable and exclusive right to purchase all or part of the equity interests in Xiaomi Inc. from the respective equity holders at a minimum purchase price when it is permitted under laws and regulations in mainland China. Xiaomi Communications may exercise such options at any time until it has acquired all equity interests of Xiaomi Inc.; and

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

1 General information (continued)

- obtain a pledge over the entire equity interests of Xiaomi Inc. from its respective equity holders as collateral security for all of Xiaomi Inc.'s payments due to Xiaomi Communications and to secure performance of Xiaomi Inc.'s obligation under the Contractual Arrangements.

As a result of the Contractual Arrangements, the Group has rights to exercise power over Xiaomi Inc. and its subsidiaries, receives variable returns from its involvement in Xiaomi Inc. and its subsidiaries, has the ability to affect those returns through its power over Xiaomi Inc. and its subsidiaries and is considered to control Xiaomi Inc. and its subsidiaries. Consequently, the Company regards Xiaomi Inc. and its subsidiaries as controlled structured entities and consolidated the assets, liabilities and results of operations of Xiaomi Inc. and its subsidiaries in the consolidated financial information of the Group.

Nevertheless, the Contractual Arrangements may not be as effective as direct legal ownership in providing the Group with direct control over Xiaomi Inc. and its subsidiaries. Uncertainties presented by the legal system in mainland China could impede the Group's beneficiary rights of the results, assets and liabilities of Xiaomi Inc. and its subsidiaries. The directors of the Company, based on the advice of its legal counsel, consider that the Contractual Arrangements among Xiaomi Communications, Xiaomi Inc. and its equity holders are in compliance with the relevant laws and regulations in mainland China and are legally binding and enforceable.

Other Contractual Arrangements were also executed for other operating companies in mainland China established by the Group similar to Xiaomi Inc. subsequently. All of these operating companies are treated as controlled structured entities of the Company and their financial statements have also been consolidated by the Company. See details in Note 12(a).

On July 9, 2018, the Company has successfully listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**") and made an offering of 2,179,585,000 Class B ordinary shares (excluding any Class B ordinary shares issued pursuant to the exercise of the over-allotment option) at a price at Hong Kong Dollar ("**HK$**") 17.00 per share. Additionally, the Company issued and allotted 201,486,000 Class B ordinary shares on July 20, 2018 pursuant to the full exercise of the over-allotment option as disclosed in the announcement of the Company dated July 18, 2018. The gross proceeds received by the Company was approximately HK$27,810,742,000 (equivalent to approximately RMB23,525,107,000), refer to Note 25(f) for details. All convertible redeemable preferred shares ("**Preferred Shares**") were converted into Class B ordinary shares upon completion of the initial public offering ("**IPO**") on July 9, 2018, refer to Note 35 for details.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied throughout all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with all applicable International Financial Reporting Standards ("**IFRSs**") issued by International Accounting Standards Board ("**IASB**") and disclosure requirements of the Hong Kong Companies Ordinance.

The Group has already adopted IFRS 9 "Financial Instruments" ("**IFRS 9**") and IFRS 15 "Revenue from Contracts with Customers" ("**IFRS 15**") upon its first time adoption of IFRSs from January 1, 2015.

The consolidated financial statements of the Group have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities which are carried at fair value.

The preparation of consolidated financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

2.2 Changes in accounting policy and disclosures

(a) New standards and amendments to existing standards adopted by the Group

The following interpretation, amendments and improvements to standards, which are relevant to the Group, are first effective from January 1, 2018.

- Annual Improvements to IFRSs 2014–2016 Cycle
- Amendments to IAS 40 Transfers of Investment Property
- IFRIC-Int 22 Foreign Currency Transactions and Advance Consideration
- Amendments to IFRS 2 Classification and Measurement of Share-based Payments Transactions

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policy and disclosures (continued)

(a) New standards and amendments to existing standards adopted by the Group (continued)

The adoption of these interpretation and amendments to standards has had no significant impact on the results and the financial position of the Group.

(b) New standards and interpretations not yet adopted

Standards, amendments and interpretations that have been issued but not yet effective and not been early adopted by the Group during the year are as follows:

		Effective for annual period beginning on or after
IFRS 16	Leases	January 1, 2019
IFRS 17	Insurance contracts	January 1, 2021
IFRIC 23	Uncertainty over income tax treatments	January 1, 2019
Amendments to IAS 19	Employee benefits on plan amendment, curtailment or settlement	January 1, 2019
Amendments to IFRS	Annual Improvements to IFRSs Standards 2015–2017 Cycle	January 1, 2019
Amendment to IFRS 3	Definition of a business	January 1, 2020
Amendments to IAS 1 and IAS 8	Definition of material	January 1, 2020
Amendments to IAS 28	Long-term interests in associates and joint ventures	January 1, 2019
Amendment to IFRS 9	Prepayment features with negative compensation	January 1, 2019

None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for the following as set out below:

IFRS 16 "Leases" ("**IFRS 16**")

IFRS 16 was issued in January 2016. It will result in almost all leases being recognized on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized. The only exceptions are short-term and low-value leases.

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policy and disclosures (continued)

(b) New standards and interpretations not yet adopted (continued)

The Group will apply the standard from its mandatory adoption date of January 1, 2019. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. All right-of-use assets will be measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses).

The Group has reviewed all of the Group's leasing arrangements over the last year in light of the new lease accounting rules in IFRS 16. The standard will affect primarily the accounting for the Group's operating leases. As of December 31, 2018, the Group has non-cancellable operating lease commitments of RMB1,029,240,000. Of these commitments, approximately RMB258,968,000 relate to short-term leases which will be recognized on a straight-line basis as expense in profit or loss. For the remaining lease commitments of RMB770,272,000, the Group expects to recognize right-of-use assets and lease liabilities (adjusted for any prepaid or accrued lease expense) on January 1, 2019, respectively.

2.3 Subsidiaries

2.3.1 Consolidation

A subsidiary is an entity (including a structured entity) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Intra-group transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. When necessary, amounts reported by subsidiaries have been adjusted to conform with the Group's accounting policies.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.3 Subsidiaries (continued)

2.3.1 Consolidation (continued)

(a) Subsidiaries controlled through Contractual Arrangements

There are entities controlled by the Group under Contractual Arrangements. The Group does not have legal ownership in equity of these structured entities or their subsidiaries. Nevertheless, under Contractual Arrangements entered into with the registered owners of these structured entities, the Company and its other legally owned subsidiaries control these companies by way of controlling the voting rights, governing their financial and operating policies, appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. Accordingly, the Group has rights to exercise power over these structured entities, receives variable returns from its involvement in these structured entities, and has the ability to affect those returns through its power over these structured entities. As a result, they are presented as controlled structured entities of the Group.

(b) Business combination

The Group applies the acquisition method to account for business combinations except for business combination under common control. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date; any gains or losses arising from such remeasurement are recognized in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.3 Subsidiaries (continued)

2.3.1 Consolidation (continued)

(b) Business combination (continued)

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IFRS 9 in profit or loss. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net assets of the business acquired in the case of a bargain purchase, the difference is recognized directly in the profit or loss.

An acquisition of a business which is a business combination under common control is accounted for in a manner similar to a uniting of interests whereby the assets and liabilities acquired are accounted for at carryover predecessor values to the other party to the business combination within all periods presented as if the operations of the Group and the business acquired have always been combined. The difference between the consideration paid by the Group and the net assets or liabilities of the business acquired is adjusted against equity.

(c) Changes in ownership interests in subsidiaries without change of control

Transactions with non-controlling interests that do not result in a loss of control are accounted for as equity transactions—that is, as transactions with the owners of the subsidiary in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

(d) Disposal of subsidiaries

When the Group ceases to have control, any retained interest in the entity is re-measured to its fair value at the date when control is lost, with the change in carrying amount recognized in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognized in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. It means the amounts previously recognized in other comprehensive income ("**OCI**") are reclassified to profit or loss, or transferred to another category of equity as specified/ permitted by applicable IFRSs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.3 Subsidiaries (continued)

2.3.2 Separate financial statements

Investments in subsidiaries (including controlled structured entities) are accounted for at cost less impairment. Cost includes direct attributable costs of investment. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

Impairment testing of the investments in subsidiaries is required upon receiving a dividend from these investments if the dividend exceeds the total comprehensive income of the subsidiary in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial information of the investee's net assets including goodwill.

2.4 Associates

An associate is an entity over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

(a) Investments in associates in the form of ordinary shares

Investments in associates in the form of ordinary shares are accounted for using the equity method of accounting in accordance with IAS 28 "Investments in Associates and Joint Ventures". Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The Group's investments in these associates include goodwill identified on acquisition, net of any accumulated impairment loss. Upon the acquisition of the ownership interest in an associate, any difference between the cost of the associate and the Group's share of the net fair value of the associate's identifiable assets and liabilities is accounted for as goodwill.

If the ownership interest in an associate in the form of ordinary shares is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income is reclassified to consolidated income statement where appropriate.

The Group's share of the associates' post-acquisition profit or loss is recognized in the consolidated income statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

2 Summary of significant accounting policies (continued)

2.4 Associates (continued)

(a) Investments in associates in the form of ordinary shares (continued)

The Group determines at each reporting date whether there is any objective evidence that the investments in the associate are impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and includes the amount in "other gains, net" in the consolidated income statement.

Profits and losses resulting from upstream and downstream transactions between the Group and its associate are recognized in the Group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealized losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Gain or losses on dilution of equity interest in associates are recognized in the consolidated income statement.

(b) Investments in associates in the form of ordinary shares with preferential rights or convertible redeemable preferred shares

Investments in associates in the form of ordinary shares with preferential rights or convertible redeemable preferred shares are accounted as financial assets measured at fair value through profit or loss (Note 2.11).

2.5 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker ("**CODM**"). The CODM, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer that makes strategic decisions.

2.6 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial information of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "**functional currency**"). The functional currency of the Company is United States dollar ("**US$**"). The Company's primary subsidiaries were incorporated in mainland China and these subsidiaries considered RMB as their functional currency. As the major operations of the Group are within mainland China, the Group determined to present its consolidated financial statements in RMB (unless otherwise stated).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.6 Foreign currency translation (continued)

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated income statement. Foreign exchange gains and losses are presented in the consolidated income statement within "other gains, net".

Translation differences on non-monetary financial assets and liabilities are recognized in profit or loss as part of the fair value changes.

(c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

- all resulting currency translation differences are recognized in other comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Currency translation differences arising are recognized in other comprehensive income.

(d) Disposal of foreign operation and partial disposal

On the disposal of a foreign operation (that is, a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a joint venture that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the currency translation differences accumulated in equity in respect of that operation attributable to the owners of the Company are reclassified to profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.6 Foreign currency translation (continued)

(d) Disposal of foreign operation and partial disposal (continued)

In the case of a partial disposal that does not result in the Group losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated currency translation differences are re-attributed to non-controlling interests and are not recognized in profit or loss. For all other partial disposals (that is, reductions in the Group's ownership interest in associates or joint ventures that do not result in the Group losing significant influence or joint control), the proportionate share of the accumulated exchange difference is reclassified to profit or loss.

2.7 Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Depreciation on property and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

— Leasehold improvements	Estimated useful lives or remaining lease terms, whichever is shorter
— Electronic equipment	3 years
— Office equipment	3–5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Construction in progress mainly represents office buildings under construction, which is stated at actual construction cost less accumulated impairment losses. Construction in progress is transferred to appropriate categories of property and equipment upon the completion of their respective construction and depreciated over their respective estimated useful lives.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.10).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within "other gains, net" in the consolidated income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.8 Land use rights

Land use rights represent prepayments for the land use rights in mainland China and are stated at cost initially and expensed on a straight-line basis over the periods of the leases.

2.9 Intangible assets

(a) Goodwill

Goodwill arises from the acquisition of subsidiaries represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identified net assets acquired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units ("**CGUs**"), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal. Any impairment is recognized immediately as an expense and is not subsequently reversed.

(b) License

License includes third-party payment license and other licenses. Third-party payment license represents the license issued by the People's Republic of China government authorities that enable the Group to operate third-party payment business. Other licenses mainly include the licenses to use certain intellectual properties purchased from third parties. These acquired licenses are shown at historical cost. License that have an indefinite useful life are tested annually for impairment and carried at cost less accumulated impairment losses. Others are amortized over their estimated useful lives of 1 to 10 years using straight-line method.

(c) Trademarks, patents and domain name

Separately acquired trademarks, patents and domain name are shown at historical cost. Trademarks, patents and domain name acquired in a business combination are recognized at fair value at the acquisition date. Trademarks, patents and domain name have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks, patents and domain name over their estimated useful lives of 1 to 16 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.9 Intangible assets (continued)

(d) Other intangible assets

Other intangible assets mainly include computer software. They are initially recognized and measured at costs incurred to acquire and bring them to use. Other intangible assets are amortized on a straight-line basis over their estimated useful lives, and recorded in amortization within operating expenses in the consolidated income statement.

(e) Research and development expenditures

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalized as intangible assets when recognition criteria are fulfilled. These criteria include:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred.

2.10 Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.11 Financial assets

2.11.1 Classification

The Group classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss), and

- those to be measured at amortized cost.

The classification depends on the Group's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in debt instruments, this will depend on the business model in which the investment is held. For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income.

See Note 18 for details of each type of financial asset.

The Group reclassifies debt investments when and only when its business model for managing those assets changes.

2.11.2 Measurement

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are recorded in profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

2 Summary of significant accounting policies (continued)

2.11 Financial assets (continued)

2.11.2 Measurement (continued)

Debt instruments

Subsequent measurement of debt instruments depends on the Group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Group classifies its debt instruments:

- Amortized cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortized cost. A gain or loss on a debt investment that is subsequently measured at amortized cost and is not part of a hedging relationship is recognized in profit or loss when the asset is derecognized or impaired. Interest income from these financial assets is included in finance income using the effective interest method.

- Fair value through other comprehensive income ("**FVOCI**"): Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss and recognized in other gains, net. Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains, net.

- Fair value through profit or loss ("**FVPL**"): Assets that do not meet the criteria for amortized cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL and is not part of a hedging relationship is recognized in profit or loss and presented net in the statement of profit or loss within other gains, net in the period in which it arises.

Equity instruments

The Group subsequently measures all equity investments at fair value. Where the Group's management has elected to present fair value gains and losses on equity investments in OCI, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment. Dividends from such investments continue to be recognized in profit or loss as other income when the Group's right to receive payments is established.

Changes in the fair value of financial assets at FVPL are recognized in the consolidated income statement. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.11 Financial assets (continued)

2.11.3 Impairment

The Group has types of financial assets subject to IFRS 9's new expected credit loss model:

- loan receivables from internet finance business;
- trade receivables for sales of goods or provision of services; and
- other receivables

The Group assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortized cost including loan receivables, and with the exposure arising from financial guarantee contracts. The impairment methodology applied depends on whether there has been a significant increase in credit risk. Note 3.1(b) details how the Group determines whether there has been a significant increase in credit risk.

For trade receivables, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognized from initial recognition of the receivables.

Impairment on other receivables is measured as either 12-month expected credit losses or lifetime expected credit loss, depending on whether there has been a significant increase in credit risk since initial recognition. If a significant increase in credit risk of a receivable has occurred since initial recognition, then impairment is measured as lifetime expected credit losses.

2.11.4 Derecognition

Financial assets

The Group derecognizes a financial asset, if the part being considered for derecognition meets one of the following conditions: (i) the contractual rights to receive the cash flows from the financial asset expire; or (ii) the contractual rights to receive the cash flows of the financial asset have been transferred, the Group transfers substantially all the risks and rewards of ownership of the financial asset; or (iii) the Group retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to the eventual recipient in an agreement that meets all the conditions of de-recognition of transfer of cash flows ("pass through" requirements) and transfers substantially all the risks and rewards of ownership of the financial asset.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.11 Financial assets (continued)

2.11.4 Derecognition (continued)

Financial assets (continued)

Where a transfer of a financial asset in its entirety meets the criteria for derecognition, the difference between the two amounts below is recognized in profit or loss:

- the carrying amount of the financial asset transferred; and
- the sum of the consideration received from the transfer and any cumulative gain or loss that has been recognized directly in equity.

If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group continues to recognize the asset to the extent of its continuing involvement and recognizes an associated liability.

Asset-backed securities

As part of its operations, the Group securitizes financial assets, generally through the sale of these assets to special purpose vehicles which issue securities to investors. Further details on prerequisites for derecognition of financial assets are set out above. When the securitization of financial assets that qualify for derecognition, the relevant financial assets are derecognized in their entirety and a new financial asset or liabilities is recognized regarding the interest in the unconsolidated securitization vehicles that the Group acquired. When the securitization of financial assets that do not qualify for derecognition, the relevant financial assets are not derecognized, and the consideration paid by third parties are recorded as a financial liability; when the securitization of financial assets that partially qualify for derecognition, the book value of the transferred asset should be recognized between the derecognized portion and the retained portion based on their respective relative fair values, and the difference between the book value of the derecognized portion and the total consideration paid for the derecognized portion shall be recorded in profit or loss.

Other financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged, canceled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognized in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.12 Financial guarantee contracts

Financial guarantee contracts are recognized as a financial liability at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of

- the amount determined in accordance with the expected credit loss model under IFRS 9 and
- the amount initially recognized less, where appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15.

The fair value of financial guarantees is determined based on the present value of the difference in cash flows between the contractual payments required under the debt instrument and the payments that would be required without the guarantee, or the estimated amount that would be payable to a third party for assuming the obligations.

Where guarantees in relation to loans or other payables of associates are provided for no compensation, the fair values are accounted for as contributions and recognized as part of the cost of the investment.

2.13 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials, assembly cost and other direct costs. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs to completion, applicable variable selling expense and related tax.

2.14 Trade and other receivables

Trade receivables are amounts due from customers for products sold or services performed in the ordinary course of business. Majority of other receivables are amounts due from outsourcing partners for raw material delivered in the ordinary course of business and value-added tax and other tax recoverable. If collection of trade and other receivables is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. See Note 2.11.3 for a description of the Group's impairment policy for trade and other receivables.

2 Summary of significant accounting policies (continued)

2.15 Loan receivables

Loan receivables held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are recognized initially at fair value plus transaction costs that are attributable to the acquisition of the assets and subsequently measured at amortized cost using the effective interest method, less provision for impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and includes fees or costs that are an integral part of the effective interest rate. The effective interest rate amortization is included in the profit or loss. The loss arising from impairment is recognized in profit or loss. See Note 2.11.3 for a description of the Group's impairment policy for loan receivables.

2.16 Cash and cash equivalents

In the consolidated statements of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

2.17 Share capital

Ordinary shares are classified as equity. Convertible redeemable preferred shares are classified as liabilities (see Note 2.19).

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds.

2.18 Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.19 Convertible redeemable preferred shares

Convertible redeemable preferred shares issued by the Company are redeemable at the option of the holders at any time commencing on the redemption start date of December 23, 2019. This instrument can be converted into Class B ordinary shares of the Company at the option of a holder after July 3, 2015, or automatically converted into ordinary shares upon occurrence of (i) the closing of a Qualified Public Offering ("**QPO**", as defined in Note 35), or (ii) with written consent of holders of more than fifty percent (50%) of the issued and outstanding Series A Preferred Shares, or written consent of holders of more than two thirds (2/3) of the issued and outstanding Preferred Shares (other than Series A Preferred Shares), as detailed in Note 35.

The Group designated the Preferred Shares as financial liabilities at fair value through profit or loss. They are initially recognized at fair value. Any directly attributable transaction costs are recognized as finance costs in the consolidated income statement.

Subsequent to initial recognition, the Preferred Shares are carried at fair value with changes in fair value recognized in the consolidated income statement.

The Preferred Shares are classified as non-current liabilities if the Preferred Shares holders cannot demand the Company to redeem the Preferred Shares for at least 12 months after the end of the reporting period.

2.20 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as a pre-payment for liquidity services and amortized over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.21 Borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.22 Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or directors, where appropriate.

2.23 Current and deferred income tax

The income tax expense for the period comprises current and deferred tax. Income tax is recognized in the consolidated income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the income tax is also recognized in other comprehensive income or directly in equity, respectively.

(a) Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.23 Current and deferred income tax (continued)

(b) Deferred income tax

Inside basis differences

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Outside basis differences

Deferred income tax liabilities are provided on taxable temporary differences arising from investments in subsidiaries, associates and joint arrangements, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. Generally the Group is unable to control the reversal of the temporary difference for associates. Only when there is an agreement in place that gives the Group the ability to control the reversal of the temporary difference in the foreseeable future, deferred tax liability in relation to taxable temporary differences arising from the associate's undistributed profits is not recognized.

Deferred income tax assets are recognized on deductible temporary differences arising from investments in subsidiaries and associates only to the extent that it is probable the temporary difference will reverse in the future and there is sufficient taxable profit available against which the temporary difference can be utilized.

(c) Offsetting

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.24 Employee benefits

(a) Pension obligations

The Group operates a mandatory provident fund scheme ("**MPF Scheme**") for the eligible employees in Hong Kong. The MPF Scheme is a defined contribution scheme, the assets of which are held in separate trustee — administered funds. The Group's contributions to MPF Scheme are expensed as incurred.

The Group's subsidiaries operating in mainland China have to make contribution to staff retirement scheme managed by local government authorities in accordance with the relevant rules and regulations. Contributions to these schemes are charged to the consolidated income statement as and when incurred. The Group has no legal or constructive obligations to pay further contributions.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognized when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick leave and maternity leave are not recognized until the time of leave.

(c) Bonus plans

The expected cost of bonuses is recognized as a liability when the Group has a present legal or constructive obligation for payment of bonus as a result of services rendered by employees and a reliable estimate of the obligation can be made. Liabilities for bonus plans are expected to be settled within 1 year and are measured at the amounts expected to be paid when they are settled.

2.25 Share-based payment

(a) Equity-settled share-based payment transactions

The Group operates share incentive plan, under which it receives services from employees as consideration for equity instruments (restricted shares units ("**RSUs**") and options) of the Company. The fair value of the services received in exchange for the grant of the equity instruments (RSUs and options) is recognized as an expense on the consolidated income statement with a corresponding increase in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.25 Share-based payment (continued)

(a) Equity-settled share-based payment transactions (continued)

In terms of the RSUs and options awarded to employees, the total amount to be expensed is determined by reference to the fair value of equity instruments (RSUs and options) granted:

- including any market performance conditions;
- excluding the impact of any service and non-market performance vesting conditions; and
- including the impact of any non-vesting conditions.

Service and non-marketing performance conditions are included in calculation of the number of RSUs and options that are expected to vest. The total amount expensed is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied.

At the end of each reporting period, the Group revises its estimates of the number of RSUs and options that are expected to vest based on the non-marketing performance and service conditions. It recognizes the impact of the revision to original estimates, if any, in the consolidated income statement, with a corresponding adjustment to equity.

In some circumstances, employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognizing the expense during the period between service commencement period and grant date.

When the options are exercised, the Company issues new ordinary shares. The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium.

(b) Cash-settled share-based payment transactions

The cost of cash-settled transactions is measured initially at fair value at the grant date. This fair value is with recognition of a corresponding liability. The liability is re-measured at each reporting date up to and at the date of settlement, with any changes in fair value recognized in profit or loss for the year.

2 Summary of significant accounting policies (continued)

2.26 Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

(a) Warranty provision

The Group records warranty liabilities at the time of sale for the estimated costs that will be incurred under its basic limited warranty. The specific warranty terms and conditions vary depending upon the product and the country in which it was sold, but generally includes technical support, repair parts and labor associated with warranty repair and service actions. The period ranges from one to three years. The Group revaluates its estimates on an annual basis to assess the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

2.27 Revenue recognition

The Group principally derives revenue from sales of products and provision of internet services.

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods sold or services performed, stated net of discounts, returns and value-added taxes. The Group recognizes revenue when the specific criteria have been met for each of the Group's activities, as described below.

(a) Sales of products

Revenue from the sales of products (mainly including smartphones, IoT and lifestyle products) directly to customers, is recognized when control of the goods has transferred, being when the products are accepted by the customers. The customers have full discretion over the products, and there is no unfulfilled obligation that could affect the customers' acceptance of the products.

2 Summary of significant accounting policies (continued)

2.27 Revenue recognition (continued)

(a) Sales of products (continued)

Customers in mainland China have an unconditional right to return the products purchased online within 7 days. The Group bases its estimates of sales return on historical results, taking into consideration the type of customers, the type of transactions and the specifics of each arrangement.

(b) Internet services

Internet services mainly comprise advertising services and internet value-added services.

(i) Advertising services

Advertising revenues comprise mainly display-based and performance-based advertisements.

Revenue from display-based advertisements to the users of smartphones and other devices is recognized on a straight-line basis over the contracted period with customers in which the advertisements are displayed.

Revenue from performance-based advertisements is recognized based on actual performance measurement. The Group recognizes the revenue from the delivery of (i) per-click when the users click on the content, (ii) per-impression when the advertising contents are displayed to users, or (iii) per-download when the third parties' apps are downloaded by users.

(ii) Internet value-added services

The Group recognizes the internet value-added services revenue (including online game) on a gross or net basis depending on whether the Group is acting as a principal or an agent in the transaction. The Group also defers the related revenue, over the estimated user relationship periods, given there is an explicit or implicit obligation of the Group to maintain the relevant applications and allow users to have access to them.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.27 Revenue recognition (continued)

Determining whether revenue of the Group should be reported gross or net is based on a continuing assessment of various factors. When determining whether the Group is acting as the principal or agent in offering goods or services to the customer, the Group needs to first identify who controls the specified goods or services before they are transferred to the customer. The Group is a principal if the Group obtains control through any of the following: (i) a good or another asset from the other party that the Group then transfers to the customer; (ii) a right to a service to be performed by the other party, which gives the Group the ability to direct that party to provide the service to the customer on the Group's behalf; (iii) a good or service from the other party that the Group then combines with other goods or services in providing the specified good or service to the customer. If control is unclear, when the Group is primarily obligated in a transaction, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, the Group records revenues on a gross basis. Otherwise, the Group records the net amount earned as commissions from products sold or services provided.

The Group does not expect to have any contracts where the period between the transfer of the promised goods or services to the customer and payment by the customer exceeds one year. As a consequence, the Group does not adjust any of the transaction prices for the time value of money.

2.28 Interest income

Interest income from financial assets at FVPL is included in investment income as part of other income.

Interest income on financial assets at amortized cost calculated using the effective interest method is recognized in the statement of profit or loss as part of other income.

Interest income is presented as finance income where it is earned from financial assets that are held for cash management purposes.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for financial assets that subsequently become credit-impaired. For credit-impaired financial assets the effective interest rate is applied to the net carrying amount of the financial asset (after deduction of the loss allowance).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

2 Summary of significant accounting policies (continued)

2.29 Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing:

- the profit attributable to owners of the Company, excluding any costs of servicing equity other than ordinary shares.

by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year and excluding treasury shares.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account:

- the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, and
- the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

2.30 Dividend income

Dividends are received from financial assets measured at FVPL and at FVOCI. Dividends are recognized as other income in profit or loss when the right to receive payment is established. This applies even if they are paid out of pre-acquisition profits, unless the dividend clearly represents a recovery of part of the cost of an investment. In this case, the dividend is recognized in OCI if it relates to an investment measured at FVOCI. However, the investment may need to be tested for impairment as a consequence.

2.31 Government grants

Grants from government are recognized at their fair value where there is a reasonable assurance that the grants will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognized in the consolidated income statement over the period necessary to match them with the costs that they are intended to compensate. Government grants relating to the property and equipment, and other non-current assets are included in the liabilities and are credited to consolidated income statement on a straight-line basis over the expected lives of the related assets.

2 Summary of significant accounting policies (continued)

2.32 Operating leases

Leases of plant and equipment and office where the Group, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the repayment of lease liability and finance cost. The finance cost is charged to the profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property and equipment acquired under finance leases is depreciated over the asset's useful life or over the shorter of the asset's useful life and the lease term if there is no reasonable certainty that the Group will obtain ownership at the end of the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the consolidated income statement on a straight-line basis over the period of the lease.

3 Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. Risk management is carried out by the senior management of the Group.

(a) Market risk

(i) Foreign exchange risk

The transactions of the Company are denominated and settled in its functional currency, US$. The Group's subsidiaries operate in mainland China and overseas, and they are exposed to foreign exchange risk arising from various currency exposures, primarily with respect to US$ and RMB. Therefore, foreign exchange risk primarily arose from recognized assets and liabilities in the Group's subsidiaries in mainland China when receiving or to receive foreign currencies from, or paying or to pay foreign currencies to overseas business partners, and recognized assets and liabilities in the Group's overseas subsidiaries when receiving or to receive foreign currencies from, or paying or to pay foreign currencies to business partners in mainland China.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(a) Market risk (continued)

(i) Foreign exchange risk (continued)

For the Group's subsidiaries whose functional currency is RMB, if RMB had strengthened/weakened by 5% against US$ with all other variables held constant, the profit before income tax for the year ended December 31, 2018 would have been approximately RMB148,939,000 higher/lower (2017: RMB124,351,000 lower/higher), as a result of net foreign exchange gains (2017: net foreign exchange losses) on translation of net monetary liabilities (2017: net monetary assets) denominated in US$.

For the Company and the Group's subsidiaries whose functional currency is US$, if RMB had strengthened/weakened by 5% against US$ with all other variables held constant, the profit before income tax for the year ended December 31, 2018 would have been approximately RMB213,622,000 (2017: RMB40,187,000) lower/higher, as a result of net foreign exchange losses on translation of net monetary liabilities denominated in RMB.

(ii) Interest rate risk

The Group's interest rate risk primarily arose from borrowings with floating and fixed rates (details of which has been disclosed in Note 33), short-term investments measured at amortized cost, loan receivables, short-term bank deposits and cash and cash equivalents. Those carried at floating rates expose the Group to cash flow interest rate risk whereas those carried at fixed rates expose the Group to fair value interest rate risk.

If the interest rate of borrowings with floating rate had been 50 basis points higher/lower, the profit before income tax for the year ended December 31, 2018 would have been approximately RMB17,158,000 (2017: RMB16,336,000) lower/higher. This analysis does not include the effect of interest capitalized.

If the interest rate of cash and cash equivalents had been 50 basis points higher/lower, the profit before income tax for the year ended December 31, 2018 would have been RMB151,151,000 (2017: RMB57,816,000) higher/lower.

The Group regularly monitors its interest rate risk to ensure there is no undue exposure to significant interest rate movements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(a) Market risk (continued)

(iii) Price risk

The Group is exposed to price risk in respect of the long-term investments and short-term investments measured at fair value through profit or loss held by the Group. The Group is not exposed to commodity price risk. To manage its price risk arising from the investments, the Group diversifies its portfolio. Each investment is managed by senior management on a case by case basis. The sensitivity analysis is performed by management, see Note 3.3 for detail.

(b) Credit risk

The Group is exposed to credit risk in relation to its cash and cash equivalents, short-term bank deposits, restricted cash, short-term investments, loan receivables, trade receivables, other receivables, and financial guarantee contracts. The carrying amounts of each class of the above financial assets represent the Group's maximum exposure to credit risk in relation to financial assets.

To manage risk arising from cash and cash equivalents, short-term bank deposits, restricted cash, short-term investments, the Group only transacts with state-owned or reputable financial institutions in mainland China and reputable international financial institutions outside of mainland China. There has been no recent history of default in relation to these financial institutions.

To manage risk arising from trade receivables, the Group has policies in place to ensure that credit terms are made to counterparties with an appropriate credit history and the management performs ongoing credit evaluations of its counterparties. The credit period granted to the customers is usually no more than 180 days and the credit quality of these customers is assessed, which takes into account their financial position, past experience and other factors. In view of the sound collection history of receivables due from them, management believes that the credit risk inherent in the Group's outstanding trade receivable balances due from them is not significant.

For other receivables, management makes periodic collective assessments as well as individual assessment on the recoverability of other receivables based on historical settlement records and past experiences. In view of the history of cooperation with debtors and the sound collection history of receivables due from them, management believes that the credit risk inherent in the Group's outstanding other receivable balances due from them is not significant.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

For the financial guarantee contracts, the Group has taken measures to manage credit risk, including credit examination, fraud examination and risk monitoring alert. The maximum credit risk from financial guarantee contracts is RMB4,391,098,000 as of December 31, 2018 (2017: RMB2,175,086,000), the majority of which are not credit-impaired on initial recognition and no significant increase in credit risk subsequently (as explained in Note 3.1(b)). The Group has recognized loss allowance for such losses at each of the reporting date.

To manage risk arising from loan receivables, the Group performs standardized credit management procedures. For pre-approval investigation, the Group uses its platform and systems using big data technology to optimize the review process, including credit analysis, assessment of collectability of borrowers, possibility of misconduct and fraudulent activities. In terms of credit examining management, the Group has established specific policies and procedures to assess loans offering. For subsequent monitoring, the Group has implemented credit examination on each borrower every three months. For unqualified borrowers, credit facilities granted previously could be terminated immediately. Once the loan was issued, all borrowers would be assessed by fraud examination model to prevent fraudulent behaviors. In post-loan supervision, the Group has established risk monitoring alert system through periodical monitoring, system alert, and corresponding solutions to identify impaired loans. The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default ("**PD**"), Exposure at Default ("**EAD**") and Loss Given Default ("**LGD**"). This is similar to the approach used for the purposes of measuring Expected Credit Loss ("**ECL**") under IFRS 9.

(b1) Expected credit loss model for loan receivables, as summarized below:

- The loan receivables that are not credit-impaired on initial recognition are classified in 'Stage 1' and have their credit risk continuously monitored by the Group. The expected credit loss is measured on a 12-month basis.

- If a significant increase in credit risk (as defined below) since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. The expected credit loss is measured on lifetime basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b1) Expected credit loss model for loan receivables, as summarized below (continued):

- If the financial instrument is credit-impaired (as defined below), the financial instrument is then moved to 'Stage 3'. The expected credit loss is measured on lifetime basis.

- In Stages 1 and 2, interest income is calculated on the gross carrying amount (without deducting the loss allowance). If a financial asset subsequently becomes credit-impaired (Stage 3), the Group is required to calculate the interest income by applying the effective interest method in subsequent reporting periods to the amortized cost of the financial asset (the gross carrying amount net of loss allowance) rather than the gross carrying amount.

The impairment of loan receivables was provided based on the 'three-stages' model by referring to the changes in credit quality since initial recognition.

The key judgments and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

(1) Significant increase in credit risk (SICR)

The Group considers loan receivables to have experienced a significant increase in credit risk when backstop criteria has been met. A backstop is applied and the loan receivables considered to have experienced a significant increase in credit risk if the borrower is more than 1 day past due on its contractual payments.

(2) Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, when the borrower is more than 90 days past due on its contractual payments. This has been applied to all loan receivables held by the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b1) Expected credit loss model for loan receivables, as summarized below (continued):

(3) Measuring ECL — Explanation of inputs, assumptions and estimation techniques

The expected credit loss is measured on either a 12-month ("**12M**") or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the PD, EAD and LGD.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each portfolio. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summarized. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

(4) Forward-looking information incorporated in the ECL models

The calculation of ECL incorporate forward-looking information. The Group has performed historical analysis and identified the per capita disposable income of urban residents as the key economic variables impacting credit risk and expected credit losses.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the non-linearities and asymmetries within the Group's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

(5) Grouping of instruments for losses measured on a collective basis

For expected credit loss provisions modeled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b2) Loss allowance

The loss allowance recognized in the year is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to loan receivables experiencing significant increases (or decreases) of credit risk in the year, and the subsequent "step up" (or "**step down**") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognized, as well as releases for loan receivables derecognized in the year;
- Loan receivables derecognized and write-offs of allowances related to assets that were written off during the year.

The following tables explain the changes in the loss allowance for loan receivables between the beginning and the end of the year due to these factors:

	Stage 1 RMB'000	Stage 2 RMB'000	Stage 3 RMB'000	Total RMB'000
Loss allowance as of January 1, 2018	122,584	50,757	100,327	273,668
Transfers:				
Transfer from Stage 1 to Stage 2	(74)	2,630	—	2,556
Transfer from Stage 1 to Stage 3	(2,502)	—	168,584	166,082
Transfer from Stage 2 to Stage 1	—	(13)	—	(13)
Transfer from Stage 2 to Stage 3	—	(38,453)	84,121	45,668
Transfer from Stage 3 to Stage 1	—	—	(9)	(9)
Transfer from Stage 3 to Stage 2	—	1	(2)	(1)
Change in PDs/LGDs/EADs	(17)	4	2,711	2,698
Loan receivables derecognized during the year	(108,910)	(15,333)	(25,239)	(149,482)
New loan receivables originated	90,540	89,678	316,746	496,964
Write-offs	—	—	(136,266)	(136,266)
Loss allowance as of December 31, 2018	101,621	89,271	510,973	701,865

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b2) Loss allowance (continued)

	Stage 1 RMB'000	Stage 2 RMB'000	Stage 3 RMB'000	Total RMB'000
Loss allowance as of January 1, 2017	10,592	746	3,860	15,198
Transfers:				
Transfer from Stage 1 to Stage 2	(5)	278	—	273
Transfer from Stage 1 to Stage 3	(229)	—	20,859	20,630
Transfer from Stage 2 to Stage 3	—	(390)	11,616	11,226
Change in PDs/LGDs/EADs	—	—	3,407	3,407
Loan receivables derecognized during the year	(15,247)	(357)	(512)	(16,116)
New loan receivables originated	127,473	50,480	61,097	239,050
Loss allowance as of December 31, 2017	122,584	50,757	100,327	273,668

Significant changes in the gross carrying amount of loan receivables that contributed to changes in the loss allowance were as follows:

The high volume of new loan receivables originated during the year ended December 31, 2018, aligned with the Group's organic growth objective, increased the gross carrying amount of the loan receivables by 128% (2017: 519%) with a corresponding RMB90,540,000 (2017: RMB127,473,000) increase in loss allowance measured on a 12-month basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b2) Loss allowance (continued)

The gross carrying amount of the loan receivables explains their significance to the changes in the loss allowance as discussed above:

	Stage 1 RMB'000	Stage 2 RMB'000	Stage 3 RMB'000	Total RMB'000
Gross carrying amount as of January 1, 2018	8,172,340	133,327	112,494	8,418,161
Transfers:				
Transfer from Stage 1 to Stage 2	(5,381)	5,381	—	—
Transfer from Stage 1 to Stage 3	(183,244)	—	183,244	—
Transfer from Stage 2 to Stage 1	25	(25)	—	—
Transfer from Stage 2 to Stage 3	—	(91,436)	91,436	—
Transfer from Stage 3 to Stage 1	10	—	(10)	—
Transfer from Stage 3 to Stage 2	—	3	(3)	—
Loan receivables derecognized during the year other than write-offs	(7,976,884)	(41,810)	(28,232)	(8,046,926)
New loan receivables originated	10,220,612	202,200	353,886	10,776,698
Write-offs	—	—	(152,423)	(152,423)
Gross carrying amount as of December 31, 2018	10,227,478	207,640	560,392	10,995,510
Gross carrying amount as of January 1, 2017	1,579,666	24,885	8,710	1,613,261
Transfers:				
Transfer from Stage 1 to Stage 2	(554)	554	—	—
Transfer from Stage 1 to Stage 3	(23,332)	—	23,332	—
Transfer from Stage 2 to Stage 3	—	(12,993)	12,993	—
Loan receivables derecognized during the year other than write-offs	(1,555,780)	(11,891)	(1,155)	(1,568,826)
New loan receivables originated	8,172,340	132,772	68,614	8,373,726
Gross carrying amount as of December 31, 2017	8,172,340	133,327	112,494	8,418,161

There is no originated credit-impaired loan receivables of the Group during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(b) Credit risk (continued)

(b3) Write-off policy

The Group writes off loan receivables, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include ceasing enforcement activity.

The Group may write-off loan receivables that are still subject to enforcement activity. The outstanding contractual amounts of loan receivables written off during the year ended December 31, 2018 was RMB152,423,000 (2017: Nil). The Group still seeks to recover amounts it is legally owed in full, but which have been written off due to no reasonable expectation of full recovery.

(b4) Modification

The Group rarely modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximizing recovery. The Group considers the impact from such modification is not significant.

(c) Liquidity risk

The Group aims to maintain sufficient cash and cash equivalents. Due to the dynamic nature of the underlying business, the policy of the Group is to regularly monitor the Group's liquidity risk and to maintain adequate cash and cash equivalents or adjust financing arrangements to meet the Group's liquidity requirements. There are loan covenants terms for certain borrowings. As of December 31, 2018, there is no non-compliance with such loan covenants (2017: Nil).

The table below analyzes the Group's non-derivative financial liabilities and off-balance sheet guarantee liabilities into relevant maturity grouping based on the remaining year at each balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.1 Financial risk factors (continued)

(c) Liquidity risk (continued)

	Less than 1 year RMB'000	Between 1 year and 2 years RMB'000	Between 2 years and 5 years RMB'000	Over 5 years RMB'000	Total RMB'000
Group					
At December 31, 2018					
Borrowings	**3,075,194**	**6,145,202**	**450,308**	**1,260,633**	**10,931,337**
Trade payables	**46,287,271**	**—**	**—**	**—**	**46,287,271**
Other payables	**5,312,834**	**206,488**	**201,689**	**217,965**	**5,938,976**
Investment from fund investors	**—**	**—**	**—**	**2,823,504**	**2,823,504**
Off-balance sheet guarantee liabilities	**4,325,961**	**—**	**—**	**—**	**4,325,961**
At December 31, 2017					
Borrowings	3,550,801	2,820,105	3,717,184	714,023	10,802,113
Trade payables	34,003,331	—	—	—	34,003,331
Other payables	3,568,286	206,935	216,496	143,953	4,135,670
Off-balance sheet guarantee liabilities	2,152,169	—	—	—	2,152,169

Details of the description of Preferred Shares are presented in Note 35.

3.2 Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to enhance shareholders' value in the long-term.

The Group monitors capital (including share capital, share premium and Preferred Shares on an as-if-converted basis) by regularly reviewing the capital structure. As a part of this review, the Group considers the cost of capital and the risks associated with the issued share capital. The Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or repurchase the Company's shares. In the opinion of the directors of the Company, the Group has operating profits and a low level of indebtedness. As a result, capital risk is not significant for the Group and measurement of capital management is not a tool currently used in the internal management reporting procedures of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation

The table below analyzes the Group's financial instruments carried at fair value as of each balance sheet date, by level of the inputs to valuation techniques used to measure fair value. Such inputs are categorized into three levels within a fair value hierarchy as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2); and
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets that are measured at fair value at December 31, 2018:

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Long-term investments measured at fair value through profit or loss (Note 19)	5,215,898	—	13,420,310	18,636,208
Short-term investments measured at fair value through profit or loss (Note 19)	—	—	6,648,526	6,648,526
	5,215,898	—	20,068,836	25,284,734

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

The following table presents the Group's assets and liabilities that are measured at fair value at December 31, 2017:

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Long-term investments measured at fair value through profit or loss (Note 19)	5,764,532	—	13,092,429	18,856,961
Short-term investments measured at fair value through profit or loss (Note 19)	—	—	4,488,076	4,488,076
	5,764,532	—	17,580,505	23,345,037
Liabilities				
Convertible redeemable preferred shares (Note 35)	—	—	161,451,203	161,451,203

(a) **Financial instruments in level 1**

The fair value of financial instruments traded in active markets is based on quoted market prices at each of the reporting dates. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

(b) **Financial instruments in level 2**

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value of an instrument are observable, the instrument is included in level 2.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

(c) Financial instruments in level 3

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments;
- Discounted cash flow model and unobservable inputs mainly including assumptions of expected future cash flows and discount rate; and
- A combination of observable and unobservable inputs, including risk-free rate, expected volatility, discount rate for lack of marketability, market multiples, etc.

Level 3 instruments of the Group's assets and liabilities include long-term investments measured at fair value through profit or loss, short-term investments measured at fair value through profit or loss and convertible redeemable preferred shares.

The changes in level 3 instruments of Preferred Shares for the years ended December 31, 2018 and 2017 are presented in the Note 35.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

(c) Financial instruments in level 3 (continued)

The following table presents the changes in level 3 instruments of long-term investments measured at fair value through profit or loss for the years ended December 31, 2018 and 2017:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	13,092,429	9,046,509
Addition	1,727,614	858,150
Disposal	(146,908)	(428,468)
Changes in fair value	6,566,513	4,136,955
Transfer to long-term investments accounted for using the equity method	(6,523,539)	—
Transfer to level 1 financial instruments	(1,467,599)	—
Currency translation differences	171,800	(520,717)
At the end of the year	13,420,310	13,092,429
Net unrealized gains for the year	4,047,551	3,945,459

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

(c) Financial instruments in level 3 (continued)

The following table presents the changes in level 3 instruments of short-term investments measured at fair value through profit or loss for the years ended December 31, 2018 and 2017:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	4,488,076	3,437,537
Addition	140,955,400	104,284,000
Disposal	(139,154,171)	(103,417,239)
Changes in fair value	359,221	183,778
At the end of the year	6,648,526	4,488,076
Net unrealized gains for the year	23,526	21,076

The Group has a team that manages the valuation of level 3 instruments for financial reporting purposes. The team manages the valuation exercise of the investments on a case by case basis. At least once every year, the team would use valuation techniques to determine the fair value of the Group's level 3 instruments. External valuation experts will be involved when necessary.

The valuation of the level 3 instruments mainly included Preferred Shares (Note 35), long-term investments measured at fair value through profit or loss in unlisted companies (Note 19) and short-term investments measured at fair value through profit or loss (Note 19). As these instruments are not traded in an active market, their fair values have been determined by using various applicable valuation techniques, including discounted cash flows and market approach etc. Major assumptions used in the valuation for Preferred Shares are presented in Note 35.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

(c) Financial instruments in level 3 (continued)

The following table summarizes the quantitative information about the significant unobservable inputs used in recurring level 3 fair value measurements.

Description	Fair values		Significant unobservable inputs	Range of inputs		Relationship of unobservable inputs to fair values
	As of December 31, 2018 RMB'000	2017 RMB'000		As of December 31, 2018	2017	
Investments in unlisted companies measured at fair value through profit or loss	**13,420,310**	13,092,429	Expected volatility	**32%–62%**	26%–63%	The higher the expected volatility, the lower the fair value
			Discount for lack of marketability ("**DLOM**")	**5%–25%**	2%–25%	The higher the DLOM, the lower the fair value
			Risk-free rate	**2%–4%**	0%–4%	The higher the risk-free rate, the higher the fair value
Short-term investments measured at fair value through profit or loss	**6,648,526**	4,488,076	Expected rate of return	**2%–5%**	2%–5%	The higher the expected rate of return, the higher the fair value

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

3 Financial risk management (continued)

3.3 Fair value estimation (continued)

(c) Financial instruments in level 3 (continued)

If the fair values of the long-term investments and short-term investments measured at fair value through profit or loss held by the Group had been 10% higher/lower, the profit before income tax for the year ended December 31, 2018 would have been approximately RMB2,528,473,000 (2017: RMB2,334,504,000) higher/lower.

Fair value of Preferred Shares is affected by changes in the Company's equity value. If the Company's equity value had increased/decreased by 10% with all other variables held constant, the profit before income tax for the year ended December 31, 2017 would have been approximately RMB16,145,120,000 lower/higher. There would be no impact for the year ended December 31, 2018 as the Preferred Shares had been transferred out of level 3 of fair value hierarchy classifications due to the conversion to Class B ordinary shares as the result of the initial public offering of the investments.

There were no material transfers between level 1, 2 and 3 of fair value hierarchy classifications during the year ended December 31, 2018, except that certain financial assets and liabilities were transferred out of level 3 of fair value hierarchy classifications.

The carrying amounts of the Group's financial assets including cash and cash equivalents, restricted cash, short-term bank deposits, short-term investments measured at amortized cost, trade receivables, loan receivables and other receivables, and the Group's financial liabilities, including borrowing, trade payables, investment from fund investors and other payables, approximate their fair values.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

4 Critical accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Fair value of financial assets

Fair value of financial assets, in the absence of an active market, is estimated by using appropriate valuation techniques. Such valuations were based on certain assumptions about credit risk, volatility and liquidity risks associated with the instruments, which are subject to uncertainty and might materially differ from the actual results. Further details are included in Note 3.3.

(b) Impairment of loan receivables

The Group follows the guidance of IFRS 9 to determine when a loan receivable is impaired. This determination requires significant judgment and estimation. In making this judgment and estimation, the Group evaluates, among other factors, the duration of receivables and the financial health collection history of individual debtors and expected future change of credit risks, including the consideration of factors such as general economy measure, changes in macroeconomic indicators etc. Further details are included in Note 3.1 to the consolidated financial statements.

(c) Fair value of Preferred Shares

The Preferred Shares issued by the Company are not traded in an active market and the respective fair value is determined by using valuation techniques. The Group has used the discounted cash flow method to determine the underlying equity value of the Company and adopted equity allocation model to determine the fair value of the Preferred Shares. Key assumptions, such as discount rate, risk-free interest rate, lack of marketability discount and volatility are disclosed in Note 35.

All Preferred Shares had been converted into Class B ordinary shares upon the IPO on July 9, 2018 (Note 35).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

4 Critical accounting estimates and judgments (continued)

(d) Current and deferred income taxes

The Group is subject to income taxes in different jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

For temporary differences which give rise to deferred tax assets, the Group assesses the likelihood that the deferred income tax assets could be recovered. Deferred tax assets are recognized based on the Group's estimates and assumptions that they will be recovered from taxable income arising from continuing operations in the foreseeable future.

(e) Inventory provision

Inventories are stated at the lower of cost and net realizable value. Management makes provision for inventories based on historical experience and estimation of future market condition and sales. Management will adjust the provision where actual net realizable value is higher or lower than previously estimated. This requires significant judgment and estimation.

(f) Recoverability of non-financial assets and investments accounted for using the equity method

The recoverable amount of non-financial assets and investments accounted for using the equity method is the greater of its fair value less costs of disposal and value-in-use. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset, which requires significant judgment relating to level of revenue and amount of operating costs.

The Group uses all readily available information in determining an amount that is a reasonable estimation of the recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and operating costs. Changes in these estimates could have a significant impact on the carrying value of the assets and could result in further impairment charge or reversal of impairment in future periods. Additional information for the impairment assessment of investments accounted for using the equity method is disclosed in Note 12(b).

4 Critical accounting estimates and judgments (continued)

(g) Warranty provision

Warranty provision is based on the estimated cost of product warranties when revenue is recognized. Factors that affect the Group's warranty liability include the number of products sold under warranty, historical and anticipated rates of warranty claims on those products, and cost per claim to satisfy the warranty obligation. The estimation basis is reviewed on an on-going basis and revised where appropriate.

(h) Revenue

Application of various accounting principles related to the measurement and recognition of revenue requires the Group to make judgments and estimates. Specifically, significant judgments include determining whether the Group is acting as the principal in a transaction. The Group is a principal in a transaction if the Group obtains control of the products sold or services provided before they are transferred to customers. If control is unclear, when the Group is primarily obligated in a transaction, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, the Group records revenues on a gross basis. Otherwise, the Group records the net amount earned as commissions from products sold or services provided.

5 Segment information

The Group's business activities, for which discrete financial statements are available, are regularly reviewed and evaluated by the CODM. The CODM, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer that makes strategic decisions. As a result of this evaluation, the Group determined that it has operating segments as follows:

- Smartphones
- IoT and lifestyle products
- Internet services
- Others

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

5 Segment information (continued)

The CODM assesses the performance of the operating segments mainly based on segment revenue and gross profit of each operating segment. The selling and marketing expenses, administrative expenses and research and development expenses are not included in the measure of the segments' performance which is used by CODM as a basis for the purpose of resource allocation and assessment of segment performance. Fair value changes on investments measured at fair value through profit or loss, share of losses of investments accounted for using the equity method, other income, other gains-net, finance income-net, fair value changes of convertible redeemable preferred shares, and income tax expense are also not allocated to individual operating segments.

The revenues from external customers reported to CODM are measured as segment revenue, which is the revenue derived from the customers in each segment. Revenues from smartphones segment are derived from the sale of smartphones. Revenues from the IoT and lifestyle products segment primarily comprise revenues from sales of (i) the Group's other in-house products, including smart TVs, laptops, AI speakers and smart routers, and (ii) the Group's ecosystem products, including certain IoT and other smart hardware products, as well as certain lifestyle products. Revenues from internet services segment are derived from advertising services and internet value-added services. Others segment primarily comprises revenue from the Group's hardware repair services for products.

The Group's cost of sales for smartphones segment and IoT and lifestyle products segment primarily consist of (i) procurement cost of raw materials and components for the Group's in-house products, (ii) assembly cost charged by the Group's outsourcing partners for the Group's in-house products, (iii) royalty fees for certain technologies embedded in the Group's in-house products, (iv) costs, in the forms of production costs and profit-sharing, paid to the Group's partners for procuring ecosystem products, (v) warranty expenses, and (vi) provision for impairment of inventories. The Group's cost of sales for internet services segment primarily consist of (i) content fees to game developers, and (ii) bandwidth, server custody and cloud service related costs. Cost of sales for others segment primarily consists of hardware repair costs. Other information, together with the segment information, provided to the CODM, is measured in a manner consistent with that applied in the consolidated financial statements. There were no separate segment assets and segment liabilities information provided to the CODM, as CODM does not use this information to allocate resources or to evaluate the performance of the operating segments.

There were no material inter-segment sales during the years ended December 31, 2018 and 2017. The revenues from external customers reported to the CODM are measured in a manner consistent with that applied in the consolidated income statement.

5 Segment information (continued)

The segment results for the years ended December 31, 2018 and 2017 are as follows:

	Year ended December 31, 2018				
	Smartphones RMB'000	IoT and lifestyle products RMB'000	Internet services RMB'000	Others RMB'000	Total RMB'000
Segment revenues	**113,800,386**	**43,816,885**	**15,955,558**	**1,342,596**	**174,915,425**
Cost of sales	**(106,757,127)**	**(39,306,134)**	**(5,683,856)**	**(976,369)**	**(152,723,486)**
Gross profit	**7,043,259**	**4,510,751**	**10,271,702**	**366,227**	**22,191,939**

	Year ended December 31, 2017				
	Smartphones RMB'000	IoT and lifestyle products RMB'000	Internet services RMB'000	Others RMB'000	Total RMB'000
Segment revenues	80,563,594	23,447,823	9,896,389	716,936	114,624,742
Cost of sales	(73,462,255)	(21,496,958)	(3,935,638)	(575,686)	(99,470,537)
Gross profit	7,101,339	1,950,865	5,960,751	141,250	15,154,205

The reconciliation of gross profit to profit/(loss) before income tax is shown in the consolidated income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

5 Segment information (continued)

The Company is domiciled in the Cayman Islands while the Group mainly operates its businesses in mainland China. For the years ended December 31, 2018 and 2017, the geographical information on the total revenues is as follows:

	Year ended December 31,			
	2018		2017	
	RMB'000	%	RMB'000	%
Mainland China	104,944,803	60.0	82,543,462	72.0
Rest of the world (Note (a))	69,970,622	40.0	32,081,280	28.0
	174,915,425		114,624,742	

Note:

(a) Revenues outside mainland China are mainly from India, Indonesia and Western Europe.

The major customers which contributed more than 10% of the total revenue of the Group for the years ended December 31, 2018 and 2017 are listed as below:

	Year ended December 31,	
	2018	2017
	%	%
Customer A	10.9	13.5

All the revenues derived from other single external customer were less than 10% of the Group's total revenues during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

6 Revenue

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Smartphones	113,800,386	80,563,594
IoT and lifestyle products	43,816,885	23,447,823
Internet services	15,955,558	9,896,389
Others	1,342,596	716,936
	174,915,425	114,624,742

7 Other income

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Government grants	274,584	121,151
Value-added tax and other tax refunds	82,507	3,738
Dividend income	131,804	106,291
Investment income from short-term investments measured at fair value through profit or loss	335,695	162,702
Interest income from short-term investments measured at amortized cost	20,199	54,789
	844,789	448,671

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

8 Other gains, net

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Remeasurement of investments transferring from financial assets measured at fair value through profit or loss to investments accounted for using the equity method (Note 12(b))	126,614	—
Net gains on disposals of long-term investments measured at fair value through profit or loss	28,176	192,008
Gains on disposal of an investment accounted for using the equity method	—	91,429
Foreign exchanges losses, net	(14,550)	(144,265)
Others	73,041	(67,132)
	213,281	72,040

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

9 Expenses by nature

	Year ended December 31,	
	2018 RMB'000	2017 RMB'000
Cost of inventories sold	138,237,733	89,468,462
Provision for impairment of inventories (Note 23)	3,006,525	652,560
Royalty fees	4,263,421	3,447,479
Employee benefit expenses (Note 10)	17,114,892	4,050,084
Depreciation of property and equipment (Note 16)	219,523	166,515
Amortization of intangible assets (Note 17)	528,693	194,441
Promotion and advertising expenses	2,486,350	1,921,590
Content fees to game developers and video providers	1,629,144	1,383,626
Provision for loan receivables	607,180	258,470
Consultancy and professional service fees	903,076	447,612
Cloud service, bandwidth and server custody fees	1,725,218	929,872
Office rental expenses	529,497	314,388
Warranty expenses	1,068,252	1,828,622
Auditor's remuneration	51,803	36,929

During the year, the Group incurred expenses for the purpose of research and development of approximately RMB5,776,826,000 (2017: RMB3,151,401,000), which comprised employee benefits expenses of RMB4,043,476,000 (2017: RMB2,239,765,000). No significant development expenses had been capitalized for the years ended December 31, 2018 and 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

10 Employee benefit expense

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Wages, salaries and bonuses	3,565,209	2,428,247
Share-based compensation expenses (Note (a) and Note 28)	12,380,668	909,155
Contributions to pension plans	481,686	300,765
Other social security costs, housing benefits and other employee benefits	687,329	411,917
	17,114,892	4,050,084

Note:

(a) Share-based compensation expenses contain the expenses for share-based awards granted to the Group's employees and the expenses for Xiaomi Development Fund ("**Employee Fund**").

(a) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group include one director during the year ended December 31, 2018 (2017: Nil). The emoluments payable to the five highest paid individuals during the years ended December 31, 2018 and 2017 are as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Wages, salaries and bonuses	9,398	8,148
Share-based compensation expenses	10,208,783	187,572
Contributions to pension plans	71	146
Other social security costs, housing benefits and other employee benefits	70	203
	10,218,322	196,069

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

10 Employee benefit expense (continued)

(a) Five highest paid individuals (continued)

The emoluments fell within the following bands:

	Number of individuals Year ended December 31, 2018	2017
HK$10,000,001 to HK$30,000,000	—	2
HK$30,000,001 to HK$100,000,000	4	2
HK$100,000,001 to HK$150,000,000	—	1
HK$150,000,001 to HK$15,000,000,000	1	—

(b) Benefits and interests of directors

Name of Director	Fees HK$'000	Salary HK$'000	Discretionary bonuses HK$'000	Allowances and benefits in kind HK$'000	Employer's contribution to a retirement benefit scheme HK$'000	Total HK$'000
Executive Directors						
LEI, Jun	—	—	—	—	—	—
LIN, Bin	—	—	—	—	—	—
Non-executive Directors						
KOH, Tuck Lye	—	—	—	—	—	—
LIU, Qin	—	—	—	—	—	—
Independent non-executive Directors						
CHEN, Dongsheng	500	—	—	—	—	500
LEE, Ka Kit	500	—	—	—	—	500
WONG, Shun Tak	500	—	—	—	—	500

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

10 Employee benefit expense (continued)

(b) Benefits and interests of directors (continued)

During the year ended December 31, 2018, certain share based awards were granted to Lei Jun (Note 28). No benefits and interests of directors subsisted as of December 31, 2017 or at any time during the year then ended.

(c) Directors' termination benefits

No director's termination benefit subsisted as of December 31, 2018 and 2017 or at any time during all the years presented.

(d) Consideration provided to third parties for making available directors' services

No consideration provided to third parties for making available directors' services subsisted as of December 31, 2018 and 2017 or at any time during all the years presented.

(e) Information about loans, quasi-loans and other dealings in favor of directors, controlled bodies corporate by and connected entities with such directors

No loans, quasi-loans and other dealings in favor of directors, controlled bodies corporate by and connected entities with such directors subsisted as of December 31, 2018 and 2017 or at any time during all the years presented.

(f) Directors' material interests in transactions, arrangements or contracts

No significant transactions, arrangements and contracts in relation to the Group's business to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted as of December 31, 2018 and 2017 or at any time during all the years presented.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

11 Finance income, net

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Finance income:		
Interest income from bank deposits	601,065	242,518

Interest income mainly represents interest income from bank deposits, including bank balance and term deposits.

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Finance costs:		
Interest expense from financial liability measured at amortized cost (Note 29)	42,504	—
Interest expenses	415,465	258,235
Less: amount capitalized	(73,277)	(42,501)
	384,692	215,734

Interest and related expenses mainly arise from the borrowings disclosed in Notes 33.

Finance costs have been capitalized on qualifying assets at average interest rates of 5.35% per annum for the year ended December 31, 2018 (2017: 5.39%).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held			Principal activities
				As of December 31, 2018	As of December 31, 2017	As of the date of this report	
Subsidiaries							
Directly held:							
Xiaomi H.K. Limited	Hong Kong, limited liability company	April 7, 2010	HK$10,000	100%	100%	100%	Wholesale and retail of smartphones and ecosystem partners' products
Fast Pace Limited	British Virgin Islands, limited liability company	January 8, 2013	US$2	100%	100%	100%	Investment holding and investment activities
Xiaomi Ventures Limited	British Virgin Islands, limited liability company	March 21, 2013	US$1	100%	100%	100%	Investment holding and investment activities
Xiaomi Singapore Pte. Ltd.	Singapore, limited liability company	December 23, 2013	Singapore Dollar ("**SGD**")1 and US$149,000,000	100%	100%	100%	Sales of smart hardware
Xiaomi Finance Inc.	Cayman Islands, limited liability company	February 15, 2018	US$1	100%	NA	100%	Investment holding and investment activities

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities) (continued):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held As of December 31, 2018	Effective interest held As of December 31, 2017	Effective interest held As of the date of this report	Principal activities
Subsidiaries							
Indirectly held:							
Xiaomi Communications Co., Ltd.	Mainland China, limited liability company	August 25, 2010	US$130,000,000	100%	100%	100%	Sales of smartphones, sales of ecosystem partners' products and provision of customer services
Beijing Xiaomi Electronics Co., Ltd.	Mainland China, limited liability company	January 9, 2012	US$27,000,000	100%	100%	100%	Sales of smart hardware
Taiwan Xiaomi Communications Co., Ltd.	Taiwan, limited liability company	April 25, 2000	New Taiwan Dollar ("**NTD**") 5,000,000	100%	100%	100%	Sales of smart hardware
Chongqing Xiaomi Microcredit Co., Ltd.	Mainland China, limited liability company	June 12, 2015	US$450,000,000	100%	100%	100%	Internet finance and consumer loan services
Beijing Xiaomi Mobile Software Co., Ltd.	Mainland China, limited liability company	May 8, 2012	RMB288,000,000	100%	100%	100%	Software and hardware development and provision of software related services
Zhuhai Xiaomi Communications Co., Ltd.	Mainland China, limited liability company	January 25, 2013	RMB2,000,000	100%	100%	100%	Procurement and sales of smartphones, ecosystem partners' products and spare parts, procurement of raw materials

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities) (continued):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held			Principal activities
				As of December 31,		As of the date of this report	
				2018	2017		
Subsidiaries Indirectly held (continued):							
Guangdong Xiaomi Inc.	Mainland China, limited liability company	September 21, 2015	RMB1,000,000,000	100%	100%	100%	Provision of software and technology service
Guangzhou Xiaomi Communications Co., Ltd.	Mainland China, limited liability company	September 22, 2016	RMB1,000,000	100%	100%	100%	Sales of smart hardware
Timi Personal Computing Co., Ltd. (Note (d))	Mainland China, limited liability company	July 28, 2015	RMB550,000	100%	78%	100%	Sales of smart hardware
Xiaomi Communications and Logistics India Private Limited (Note (e))	India, limited liability company	April 1, 2015	Indian Rupees ("**INR**")30,000,000	100%	100%	100%	Provision of logistics services
Xiaomi Technology India Private Limited	India, limited liability company	October 7, 2014	INR100,000	100%	100%	100%	Sales of smartphones and ecosystem partners' products
Guangzhou Xiaomi Information Service Co., Ltd.	Mainland China, limited liability company	December 29, 2016	RMB1,000,000	100%	100%	100%	Provision of advertising and technology services
Xiaomi Home Commercial Co., Ltd.	Mainland China, limited liability company	June 27, 2017	RMB100,000,000	100%	100%	100%	Operation of retail stores

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities) (continued):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held As of December 31, 2018	Effective interest held As of December 31, 2017	Effective interest held As of the date of this report	Principal activities
Subsidiaries Indirectly held (continued):							
Beijing Xiaomi Digital Technology Co., Ltd.	Mainland China, limited liability company	December 21, 2010	US$7,900,000	100%	100%	100%	Research and development of computer software and information technology
Red Better Limited	British Virgin Islands, limited liability company	October 8, 2013	–	100%	100%	100%	Investment activities
Green Better Limited	British Virgin Islands, limited liability company	December 9, 2013	US$1	100%	100%	100%	Investment activities
People Better Limited	British Virgin Islands, limited liability company	April 22, 2014	–	100%	100%	100%	Investment activities
Xiaomi Home Technology Co., Ltd.	Mainland China, limited liability company	January 20, 2017	RMB80,000,000	100%	100%	100%	Operation of retail stores
Beijing Zilin Real Estate Co., Ltd.	Mainland China, limited liability company	November 29, 2018	–	95%	NA	95%	Property management
Xiaomi Commercial Factoring (Tianjin) Co., Ltd.	Mainland China, limited liability company	March 21, 2018	US$380,000,000	100%	NA	100%	Commercial factoring business

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities) (continued):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held			Principal activities
				As of December 31,		As of the date of this report	
				2018	2017		
Controlled structured entities (Note (a)):							
Xiaomi Inc.	Mainland China, limited liability company	March 3, 2010	RMB1,850,000,000	100%	100%	100%	E-commerce business
Tianjin Jinxing Venture Investment Co., Ltd.	Mainland China, limited liability company	December 26, 2013	RMB1,200,000,000	100%	100%	100%	Investment activities
Sichuan Silver Mi Technology Co., Ltd.	Mainland China, limited liability company	October 26, 2005	RMB2,000,000,000	100%	100%	100%	Research and development of computer software and market research
Jiefu Ruitong Inc. (Note (b))	Mainland China, limited liability company	January 11, 2011	RMB100,000,000	100%	65%	100%	Provision of electronic payment services
Beijing Duokan Technology Co., Ltd.	Mainland China, limited liability company	February 10, 2010	RMB10,000,000	100%	100%	100%	Sales of e-book
Beijing Wali Internet Technologies Co., Ltd.	Mainland China, limited liability company	June 1, 2009	RMB2,100,000	100%	100%	100%	Provision of internet services

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

As of December 31, 2018 and 2017, the Company had the following major subsidiaries (including controlled structured entities) (continued):

Name	Place of incorporation/ establishment and kind of legal entity	Date of incorporation/ establishment	Particulars of issued/ paid-in capital	Effective interest held As of December 31, 2018	Effective interest held As of December 31, 2017	Effective interest held As of the date of this report	Principal activities
Controlled structured entities (Note (a)) (continued):							
Tianjin Gold Mi Investment Partners (Limited Partnership)	Mainland China, limited partnership	July 16, 2014	RMB1,132,400,000	100%	100%	100%	Investment activities
Hubei Xiaomi Yangtze River Industry Investment Fund Partners (Limited Partnership) (Note (g))	Mainland China, limited partnership	December 7, 2017	RMB3,384,000,000	18%	100%	18%	Investment activities

Notes:

(a) The Company does not have directly or indirectly legal ownership in equity of these structured entities or their subsidiaries. Nevertheless, under certain Contractual Arrangements entered into with the registered owners of these structured entities, the Company and its other legally owned subsidiaries control these companies by way of controlling the voting rights, governing their financial and operating policies, appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. Accordingly, the Group has rights to exercise power over these structured entities, receives variable returns from its involvement in these structured entities, and has the ability to affect those returns through its power over these structured entities. As a result, they are presented as structured entities of the Company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(a) Major subsidiaries and controlled structured entities (continued)

Notes (continued):

(b) Jiefu Ruitong Inc. was established in mainland China on January 11, 2011 and was subsequently acquired by the Group on June 14, 2016. In July 2018, the Group agreed to pay RMB332,000,000 as consideration in exchange for certain indirect equity interests in Jiefu Ruitong Inc. to acquire the remaining equity interests in this subsidiary.

(c) The Company considered that the non-wholly owned subsidiaries with non-controlling interests are not significant to the Group, therefore, no summarized financial information of these non-wholly owned subsidiaries is presented separately.

(d) In March 2018, the Group issued Class B ordinary shares as consideration in exchange for certain indirect equity interests in Timi Personal Computing Co., Ltd. to acquire the remaining equity interests in this subsidiary.

(e) Xiaomi Communications and Logistics India Private Limited, incorporated in India and owned by Xiaomi Singapore Pte. Ltd. as to 99.9967% and Jain Manu Kumar, who is a director of Xiaomi Technology India Private Limited, as to 0.0033%.

(f) The English names of the subsidiaries are direct translation or transliteration of their Chinese registered names.

(g) Two subsidiaries of the Group together with other limited partners newly launched a RMB fund named Hubei Xiaomi Yangtze River Industry Investment Fund Partners (Limited Partnership) (湖北小米長江產業基金合夥企業(有限合夥)) (the "**Hubei Fund**") in Wuhan, Hubei province in mainland China in 2017. The size of the Hubei Fund is RMB12,000,000,000. During the year ended December 31, 2018, the Hubei Fund raised RMB2,781,000,000 from third party investors, and as a result, the Group's shareholding interest in the Hubei Fund changed from 100% to 18%.

12(b) Investments accounted for using the equity method

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Investments in associate accounted for using the equity method		
— Listed entities	6,198,681	386,490
— Unlisted entities	2,440,557	1,324,329
	8,639,238	1,710,819

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(b) Investments accounted for using the equity method (continued)

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	**1,710,819**	1,852,563
Additions (Note (a), (b), (c), (d), (e))	**7,289,333**	156,551
Disposal and transfer	**(100)**	(42,298)
Share of losses	**(614,920)**	(231,496)
Share of other comprehensive income/(loss)	**191,449**	(22,783)
Share of changes of other reserves	**62,657**	33,539
Dividends	**—**	(35,257)
At the end of the year	**8,639,238**	1,710,819

Notes:

(a) In February 2018, Huami Corp. ("**Huami**"), an investment for which was previously accounted as long-term investments measured at fair value through profit or loss underwent initial public offering on the New York Stock Exchange, following which Huami was re-designated as investment accounted for using the equity method due to the conversion of the preference shares into ordinary shares upon its initial public offering.

(b) In February 2018, the Group obtained significant influence over Ourpalm Co., Ltd. ("**Ourpalm**") through board representation, which was previously accounted for as long-term investments measured at fair value through profit or loss. Accordingly, the Group reclassified the investment in associate measured at fair value through profit or loss to an investment accounted for using the equity method.

(c) On March 29, 2018, iQIYI, Inc. ("**iQIYI**"), an investment engaging in the provision of internet video streaming services in mainland China, for which the Group accounted as long-term investments measured at fair value through profit or loss, underwent initial public offering on the NASDAQ Stock Exchange. The conversion of the preference shares in iQIYI owned by the Group into ordinary shares was completed on April 2, 2018, following which the Group reclassified the investment in associate measured at fair value through profit or loss to an investment accounted for using the equity method.

(d) On September 25, 2018, Viomi Technology Co., Ltd. ("**VIOT**"), an investment engaging in the operation of developing and selling IoT-enabled smart home products in the People's Republic of China, for which the Group accounted as long-term investments measured at fair value through profit or loss, underwent initial public offering on the NASDAQ Stock Exchange. The conversion of the preference shares in VIOT owned by the Group into ordinary shares was completed on the same day, following which the Group reclassified the investment in associate measured at fair value through profit or loss to an investment accounted for using the equity method.

(e) In October 2018, the Group acquired newly issued shares of a company which is engaged in sales of mobile devices for a consideration of RMB500,000,000. The investment was previously accounted for by the Group as an associate of the Group accounted for using the equity method with share interest of 21.94%. Following the addition, the Group owned 46.44% interest in the company which remained as an associate of the Group accounted for using the equity method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(b) Investments accounted for using the equity method (continued)

Management has assessed the level of influence that the Group exercises on these associates, with a total carrying amount of RMB8,639,238,000 as of December 31, 2018 (2017: RMB1,710,819,000), and determined that it has significant influence through the board representation, even though the respective shareholding of some investments is below 20%. Accordingly, these investments have been classified as associates.

Set out below are the material associates of the Group as of December 31, 2018 and 2017. The associates as listed below are ordinary shares investment, which held directly by the Group. Mainland China is their principal place of business.

Name of entity	Place of incorporation	% of Ownership interest	Principal activities	Quoted fair value As of December 31, 2018 RMB'000	Quoted fair value As of December 31, 2017 RMB'000	Carrying amount As of December 31, 2018 RMB'000	Carrying amount As of December 31, 2017 RMB'000
Xunlei Limited ("**Xunlei**")	Cayman Islands	27.9	Provision of cloud computing service	**597,770**	1,883,586	**304,667**	386,490
Sichuan Xin Wang Bank Co., Ltd. ("**XW Bank**")	Mainland China	29.5	Provision of internet banking service	**NA**	NA	**936,908**	827,534
iQIYI	Cayman Islands	6.8	Provision of internet video streaming services	**4,984,330**	NA	**4,377,472**	NA

The associates of the Group have been accounted by using the equity method based on the financial information of the associates prepared under the accounting policies consistent with the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(b) Investments accounted for using the equity method (continued)

Set out below are the summarized financial information of material associates.

	Xunlei		XW Bank		iQIYI
	As of December 31,		As of December 31,		As of December 31,
	2018	2017	2018	2017	2018
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Summarized consolidated balance sheets					
Current assets	2,490,648	2,814,823	28,137,561	15,074,511	19,853,443
Non-current assets	798,511	970,525	8,021,166	1,241,408	35,736,050
Current liabilities	741,466	925,870	28,454,306	13,003,685	19,812,356
Non-current liabilities	62,933	133,121	4,528,463	507,034	9,499,228
Non-controlling interests	(7,659)	(14,114)	—	—	118,632
Equity attributable to owners of the Company	2,492,419	2,740,471	3,175,958	2,805,200	26,159,277
Reconciliation to carrying amounts:					
Group's share of net assets attributable to owners of the associates	694,637	776,460	936,908	827,534	1,768,039
Adjustment					
— Goodwill	424,233	424,233	—	—	2,609,433
— Impairment provision	(814,203)	(814,203)	—	—	—
Carrying amount	304,667	386,490	936,908	827,534	4,377,472

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

12(b) Investments accounted for using the equity method (continued)

	Xunlei		XW Bank		iQIYI
					Year ended
	Year ended December 31,		Year ended December 31,		December 31,
	2018	2017	2018	2017	2018
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Summarized consolidated income statements and consolidated statements of comprehensive income					
Revenues	1,529,102	1,364,373	1,160,403	342,366	24,989,116
(Loss)/profit from operations	(399,034)	(366,252)	461,099	(241,967)	(8,420,635)
(Loss)/profit before tax	(367,587)	(313,998)	460,343	(226,174)	(9,096,829)
Net (loss)/profit	(368,127)	(255,487)	371,470	(169,569)	(9,175,630)
Other comprehensive (loss)/income	(11,482)	(59,220)	(711)	712	(1,786,820)
Total comprehensive (loss)/income	(379,609)	(314,707)	370,759	(168,857)	(10,962,450)

In addition to the interests in associates disclosed above, the Group also has interests in a number of individually immaterial associates that are accounted for using the equity method.

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Aggregate carrying amount of individually immaterial associates	3,020,191	496,795
Aggregate amounts of the Group's share of:		
Profit/(loss) from continuing operations	6,249	(67,244)
Other comprehensive income/(loss)	19,864	(6,214)
Total comprehensive income/(loss)	26,113	(73,458)

There are no contingent liabilities relating to the Group's interests in the associates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

13 Income tax expenses

The income tax expenses of the Group during the years ended December 31, 2018 and 2017 are analyzed as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Current income tax	1,414,602	1,644,674
Deferred income tax (Note 34)	(965,225)	415,089
Income tax expenses	449,377	2,059,763

The tax on the Group's profit/(loss) before income tax differs from the theoretical amount that would arise using the statutory tax rate of 25% in mainland China, being the tax rate applicable to the majority of consolidated entities as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Profit/(Loss) before income tax	13,927,124	(41,829,352)
Tax calculated at statutory income tax rate of 25% in mainland China (Note (a))	3,481,781	(10,457,338)
Tax effects of:		
— Effect of different tax rates in other jurisdictions (Note (b),(c),(d))	(2,037,227)	12,646,524
— Preferential income tax rates applicable to subsidiaries (Note (e))	(1,017,178)	(393,879)
— Tax losses and temporary differences for which no deferred income tax assets was recognized	115,452	199,363
— Expenses not deductible for income tax purposes	588,839	209,721
— Utilization of previously unrecognized deductible tax losses and temporary differences	(89,626)	(5,010)
— Super Deduction for research and development expenses (Note (f))	(166,794)	(127,993)
— Income not subject to tax	(157,306)	(26,537)
— Tax refund (Note (e))	(270,757)	—
— Others	2,193	14,912
Income tax expenses	449,377	2,059,763

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

13 Income tax expenses (continued)

Notes:

(a) Enterprise income tax in mainland China ("**EIT**")

The income tax provision of the Group in respect of its operations in mainland China was calculated at tax rate of 25% on the assessable profits for the periods presented, based on the existing legislation, interpretations and practices in respect thereof.

(b) Cayman Islands and British Virgin Islands income tax

The Company is incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law of the Cayman Islands and accordingly, is exempted from Cayman Islands income tax. As such, the operating results reported by the Company, including the fair value gain/(loss) of Preferred Shares (Note 35) and the share-based awards (Note 28), are not subject to any income tax.

The Group entities established under the International Business Companies Acts of British Virgin Islands ("**BVI**") are exempt from BVI income taxes.

(c) Hong Kong income tax

Entities incorporated in Hong Kong are subject to Hong Kong profits tax at a rate of 16.5% on the assessable profits for the years presented, based on the existing legislation, interpretations and practices in respect thereof.

(d) India income tax

The income tax provision for India entities were calculated at corporate income tax rates of 30% to 35% on the assessable profits for the years presented, based on the existing legislation, interpretations and practices in respect thereof.

(e) Preferential EIT rate

Certain subsidiaries are entitled to preferential tax rates ranging from 10% to 15%. Main subsidiaries with preferential EIT rates are as follows:

Beijing Xiaomi Mobile Software Co., Ltd. ("**Xiaomi Mobile**") was qualified as a "High and New Technology Enterprise" and enjoyed a preferential income tax rate of 15% for the year ended December 31, 2017. It was qualified as a "Key Software Enterprise" in the third quarter of 2018, hence it enjoys a preferential income tax rate of 10% retroactively from January 1, 2017. Accordingly, Xiaomi Mobile was entitled to tax refund for the income tax paid in 2017 and such tax refund was received by Xiaomi Mobile from local tax bureau in December 2018. Therefore, Xiaomi Mobile is subject to an EIT rate of 10% for the year ended December 31, 2018 (2017: 15%).

(f) Super Deduction for research and development expense

According to the relevant laws and regulations promulgated by the State Council of the People's Republic of China that was effective from 2008 onwards, enterprises engaging in research and development activities were entitled to claim 150% of their research and development expenses so incurred as tax deductible expenses when determining their assessable profits for that year ("**Super Deduction**"). The State Taxation Administration of The People's Republic of China announced in September 2018 that enterprises engaging in research and development activities would entitle to claim 175% of their research and development expenses as Super Deduction from January 1, 2018 to December 31, 2020. The Group has made its best estimate for the Super Deduction to be claimed for the Group's entities in ascertaining their assessable profits during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

13 Income tax expenses (continued)

Notes (continued):

(g) Withholding tax in mainland China ("**WHT**")

According to the New Corporate Income Tax Law ("**New EIT Law**"), distribution of profits earned by companies in mainland China since January 1, 2008 to foreign investors is subject to withholding tax of 5% or 10%, depending on the country of incorporation of the foreign investors, upon the distribution of profits to overseas-incorporated immediate holding companies.

The Group does not have any plan in the foreseeable future to require its subsidiaries in mainland China to distribute their retained earnings and intends to retain them to operate and expand its business in mainland China. Accordingly, no deferred income tax liability related to WHT on undistributed earnings was accrued as of the end of each reporting period.

14 Earnings/(loss) per share

On June 17, 2018, pursuant to the shareholders' resolution, each existing issued and unissued share of US$0.000025 each in the share capital of the Company were subdivided into 10 shares of US$0.0000025 each ("**Share Subdivision**"). Following the Share Subdivision, the weighted average number of ordinary shares for the purpose of basic and diluted earnings per share for the years ended December 31, 2018 and 2017 has been retrospectively adjusted.

(a) Basic

Basic earnings or loss per share for the years ended December 31, 2018 and 2017 are calculated by dividing the profit or loss attributable to the Company's owners by the weighted average number of ordinary shares in issue during the year.

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Net profit/(loss) attributable to the owners of the Company	13,553,886	(43,826,016)
Weighted average number of ordinary shares in issue (Note (a)) (thousand shares)	16,069,770	9,758,173
Basic earnings/(loss) per share (Note (a)) (expressed in RMB per share)	0.843	(4.491)

Note:

(a) Weighted average number of ordinary shares in issue and basic earnings/(loss) per share were calculated taken into account the effect of the Share Subdivision.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

14 Earnings/(loss) per share (continued)

(a) Basic (continued)

As of December 31, 2018, 24,000,000 ordinary shares were issued to several employees. However, the shareholders' rights of these shares were restricted and would be vested over certain service periods. Accordingly, these shares were accounted for as restricted stock units (RSUs). The Group did not include these ordinary shares in the calculation of basic earnings/(loss) per share for the years ended December 31, 2018 and 2017 as these shares are not considered outstanding for earnings/(loss) per share calculation purposes.

(b) Diluted

Diluted earnings or loss per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

As the Group incurred losses for the year ended December 31, 2017, the potential ordinary shares were not included in the calculation of dilutive loss per share, as their inclusion would be anti-dilutive. Accordingly, diluted loss per share for the year ended December 31, 2017 is same as basic loss per share.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

14 Earnings/(loss) per share (continued)

(b) Diluted (continued)

For the year ended December 31, 2018, diluted earnings or loss per share was calculated by considering that the impact of share options of Xiaomi Finance Inc., a wholly owned subsidiary of the Company ("**Xiaomi Finance**") granted to Lei Jun were not dilutive, as Xiaomi Finance was in loss position for the year ended December 31, 2018.

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Net profit/(loss) attributable to the owners of the Company	13,553,886	(43,826,016)
Less: Fair value gain of Preferred Shares	(12,514,279)	—
Net profit/(loss) used to determine diluted earnings/(loss) per share	1,039,607	(43,826,016)
Weighted average number of ordinary shares in issue (Note (a)) (thousand shares)	16,069,770	9,758,173
Adjustments for Preferred Shares (Note (a)) (thousand shares)	5,468,315	—
Adjustments for RSUs and share options granted to employees (Note (a)) (thousand shares)	2,024,845	—
Weighted average number of ordinary shares for calculation of diluted earnings/(loss) per share (Note (a)) (thousand shares)	23,562,930	9,758,173
Diluted earnings/(loss) per share (Note (a)) (expressed in RMB per share)	0.044	(4.491)

Note:

(a) Weighted average number of ordinary shares in issue, adjustments for Preferred Shares, adjustments for RSUs and share options granted to employees, weighted average number of ordinary shares for calculation of diluted earnings/(loss) per share and diluted earnings/(loss) per share were calculated taken into account the effect of the Share Subdivision.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

15 Land use rights

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Opening net book amount	3,416,359	3,494,041
Additions	64,832	—
Amortization	(78,223)	(77,682)
Closing net book amount	3,402,968	3,416,359

The Group had an aggregate amount of approximately RMB3,402,968,000 (2017: RMB3,416,359,000) of land use rights for office buildings being constructing. During the year ended December 31, 2018, the Group newly acquired a land use right in mainland China at a consideration of RMB64,832,000. The estimated useful lives of the land use rights were 40 to 50 years. The new office buildings are under construction during the year (Note 16).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

16 Property and equipment

	Electronic equipment RMB'000	Office equipment RMB'000	Leasehold improvements RMB'000	Construction in progress RMB'000	Total RMB'000
At January 1, 2018					
Cost	422,515	14,317	331,083	1,473,761	2,241,676
Accumulated depreciation	(297,588)	(11,870)	(201,346)	—	(510,804)
Net book amount	124,927	2,447	129,737	1,473,761	1,730,872
Year ended December 31, 2018					
Opening net book amount	124,927	2,447	129,737	1,473,761	1,730,872
Currency translation differences	(330)	(13)	(1,010)	13	(1,340)
Additions	242,843	19,612	243,364	3,119,183	3,625,002
Disposals/transfer	(17,071)	(1)	—	(49,886)	(66,958)
Depreciation charge (Note 9)	(87,245)	(3,740)	(128,538)	—	(219,523)
Closing net book amount	263,124	18,305	243,553	4,543,071	5,068,053
At December 31, 2018					
Cost	642,723	33,932	564,076	4,543,071	5,783,802
Accumulated depreciation	(379,599)	(15,627)	(320,523)	—	(715,749)
Net book amount	263,124	18,305	243,553	4,543,071	5,068,053

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

16 Property and equipment (continued)

	Electronic equipment RMB'000	Office equipment RMB'000	Leasehold improvements RMB'000	Construction in progress RMB'000	Total RMB'000
At January 1, 2017					
Cost	372,970	15,450	163,103	642,581	1,194,104
Accumulated depreciation	(212,314)	(10,401)	(123,012)	—	(345,727)
Net book amount	160,656	5,049	40,091	642,581	848,377
Year ended December 31, 2017					
Opening net book amount	160,656	5,049	40,091	642,581	848,377
Currency translation differences	(23)	(6)	(1)	—	(30)
Additions	50,880	17	167,981	831,180	1,050,058
Disposals	(131)	(887)	—	—	(1,018)
Depreciation charge (Note 9)	(86,455)	(1,726)	(78,334)	—	(166,515)
Closing net book amount	124,927	2,447	129,737	1,473,761	1,730,872
At December 31, 2017					
Cost	422,515	14,317	331,083	1,473,761	2,241,676
Accumulated depreciation	(297,588)	(11,870)	(201,346)	—	(510,804)
Net book amount	124,927	2,447	129,737	1,473,761	1,730,872

Construction in progress as of December 31, 2018 and 2017 mainly comprises new office buildings being constructed in mainland China.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

16 Property and equipment (continued)

Depreciation expenses have been charged to the consolidated income statement as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Administrative expenses	61,216	56,191
Selling and marketing expenses	98,941	62,763
Research and development expenses	59,366	47,561
	219,523	166,515

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

17 Intangible assets

	Goodwill (Note (a)) RMB'000	License RMB'000	Trademarks, patents and domain name RMB'000	Others RMB'000	Total RMB'000
At January 1, 2018					
Cost	248,167	1,343,686	1,003,239	107,792	2,702,884
Accumulated amortization	—	(63,735)	(280,034)	(84,763)	(428,532)
Net book amount	248,167	1,279,951	723,205	23,029	2,274,352
Year ended December 31, 2018					
Opening net book amount	248,167	1,279,951	723,205	23,029	2,274,352
Currency translation differences	—	—	(10,049)	(106)	(10,155)
Additions	33,923	71,723	110,283	116,949	332,878
Disposals	—	(7,190)	—	—	(7,190)
Amortization charge (Note 9)	—	(332,071)	(155,520)	(41,102)	(528,693)
Closing net book amount	282,090	1,012,413	667,919	98,770	2,061,192
At December 31, 2018					
Cost	282,090	1,408,219	1,084,466	224,578	2,999,353
Accumulated amortization	—	(395,806)	(416,547)	(125,808)	(938,161)
Net book amount	282,090	1,012,413	667,919	98,770	2,061,192

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

17 Intangible assets (continued)

	Goodwill (Note (a)) RMB'000	License RMB'000	Trademarks, patents and domain name RMB'000	Others RMB'000	Total RMB'000
At January 1, 2017					
Cost	248,167	375,940	643,389	88,034	1,355,530
Accumulated amortization	—	(4,361)	(168,575)	(62,461)	(235,397)
Net book amount	248,167	371,579	474,814	25,573	1,120,133
Year ended December 31, 2017					
Opening net book amount	248,167	371,579	474,814	25,573	1,120,133
Currency translation differences	—	—	(14,942)	(1)	(14,943)
Additions	—	967,746	376,098	19,759	1,363,603
Amortization charge (Note 9)	—	(59,374)	(112,765)	(22,302)	(194,441)
Closing net book amount	248,167	1,279,951	723,205	23,029	2,274,352
At December 31, 2017					
Cost	248,167	1,343,686	1,003,239	107,792	2,702,884
Accumulated amortization	—	(63,735)	(280,034)	(84,763)	(428,532)
Net book amount	248,167	1,279,951	723,205	23,029	2,274,352

Note:

(a) For the purpose of impairment tests of goodwill, goodwill is allocated to groups of cash-generating units. Such groups of cash-generating units represent the lowest level within the Group for which the goodwill is monitored for internal management purpose.

Impairment review on the goodwill of the Group has been conducted by the management as of December 31, 2018 and 2017 according to IAS 36 "Impairment of assets". For the purposes of impairment review, the recoverable amount of goodwill is determined based on value-in-use calculations by using the discounted cash flow method. Management forecasted the average annual revenue growth rate in five-year period is 5%, and the cash flows beyond the five-year period were extrapolated using the estimated annual growth rates of 2%. Pre-tax discount rate of 20% was used to reflect market assessment of time value and the specific risks relating to the CGUs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

17 Intangible assets (continued)

Note (continued):

Based on the result of the goodwill impairment testing, the estimated recoverable amount was approximately RMB2,162,337,000 as of December 31, 2018 (2017: RMB1,501,601,000). As the recoverable amount was significantly above the carrying amount, no impairment was identified in respect of the goodwill as of December 31, 2018 and 2017.

The Group has performed a sensitivity analysis on key assumptions used in management's annual impairment test of goodwill. Had the estimated revenue growth rate during the forecast period been 1% percentage lower, the recoverable amount would be decreased to RMB2,011,412,000 as of December 31, 2018 (2017: RMB1,368,728,000). Reasonably possible changes in key assumptions would not lead to impairment as of December 31, 2018 and 2017.

Amortization charges were expensed off in the following categories in the consolidated income statement:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Administrative expenses	77,468	105,162
Selling and marketing expenses	648	668
Research and development expenses	450,577	88,611
	528,693	194,441

The Group tests annually whether goodwill and other intangible assets with an indefinite useful life have suffered any impairment. During the years ended December 31, 2018 and 2017, no goodwill or other identifiable intangible assets have been impaired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

18 Financial instruments by category

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Assets as per balance sheet		
Financial assets measured at fair value through profit or loss:		
— Long-term investments measured at fair value through profit or loss (Note 19)	18,636,208	18,856,961
— Short-term investments measured at fair value through profit or loss (Note 19)	6,648,526	4,488,076
Financial assets measured at amortized costs:		
— Trade receivables (Note 21)	5,598,443	5,469,507
— Loan receivables (Note 20)	10,293,645	8,144,493
— Other receivables	12,408,170	7,506,631
— Short-term investments measured at amortized cost (Note 19)	—	800,000
— Short-term bank deposits (Note 24(c))	1,365,991	225,146
— Restricted cash (Note 24(b))	1,480,178	2,711,119
— Cash and cash equivalents (Note 24(a))	30,230,147	11,563,282
	86,661,308	59,765,215
Liabilities as per balance sheet		
Financial liabilities measured at amortized cost:		
— Trade payables (Note 30)	46,287,271	34,003,331
— Other payables (excluding staff payroll and welfare payables, government grants and other taxes payables)	4,805,101	3,076,153
— Borrowings (Note 33)	10,931,337	10,802,113
— Investment from fund investors (Note 29)	2,823,504	—
Financial liabilities measured at fair value through profit or loss:		
— Convertible redeemable preferred shares (Note 35)	—	161,451,203
	64,847,213	209,332,800

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

19 Investments

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Current assets		
Short-term investments measured at		
— Amortized cost	—	800,000
— Fair value through profit or loss (i)	6,648,526	4,488,076
	6,648,526	5,288,076
Non-current assets		
Long-term investments measured at fair value through profit or loss		
— Equity investments (ii)	7,629,929	7,448,251
— Preferred shares investments (iii)	11,006,279	11,408,710
	18,636,208	18,856,961

(i) Short-term investments measured at fair value through profit or loss

The short-term investments measured at fair value through profit or loss are wealth management products, denominated in RMB, with expected rates of return ranging from 2.20% to 5.15% per annum for the years ended December 31, 2018 (2017: 2.00% to 5.10%). The returns on all of these wealth management products are not guaranteed, hence their contractual cash flows do not qualify for solely payments of principal and interest. Therefore they are measured at fair value through profit or loss. None of these investments are past due.

The fair values are based on cash flow discounted using the expected return based on management judgment and are within level 3 of the fair value hierarchy.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

19 Investments (continued)

(ii) Equity investments

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Listed	5,215,898	5,764,532
Unlisted	2,414,031	1,683,719
	7,629,929	7,448,251

The fair values of the listed securities are determined based on the closing prices quoted in active markets. They are accounted for using their fair values based on quoted market prices (level 1: quoted price (unadjusted) in active markets) without any deduction for transaction costs. And as of December 31, 2018, the Group has not elected to recognize the fair value gains or losses on equity investments in OCI.

The fair values of unlisted securities are measured using a valuation technique with unobservable inputs and hence classified as Level 3 of the fair value hierarchy. The major assumptions used in the valuation for investment in private companies refer to Note 3.3.

(iii) Preferred shares investments

During the year ended December 31, 2018, the Group made aggregate preferred shares investments of RMB1,102,118,000 (2017: RMB369,975,000). These investees are principally engaged in sales of goods and provision of internet services.

All of these investments are convertible redeemable preferred shares or ordinary shares with preferential rights. The Group has the right to require and demand the investees to redeem all of the shares held by the Group at guaranteed predetermined fixed amount upon redemption events which are out of control of issuers. Hence, these investments are accounted for as debt instruments and are measured at financial assets at fair value through profit or loss.

The conversion of the preference shares in Huami, iQIYI and VIOT owned by the Group into ordinary shares was completed on February 8, 2018, April 2, 2018 and September 25, 2018, respectively, following which the Group reclassifies the associates to the investments accounted for using the equity method (Note 12(b)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

19 Investments (continued)

(iv) Amounts recognized in profit or loss

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Fair value changes on equity investments	(1,386,967)	2,569,974
Fair value changes on preferred shares investments	5,793,800	3,780,048
Fair value changes on short-term investments measured at fair value through profit or loss	23,526	21,076
	4,430,359	6,371,098

20 Loan receivables

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Unsecured loan	10,995,510	8,418,161
Less: allowance for impairment	(701,865)	(273,668)
	10,293,645	8,144,493

Loan receivables are loans derived from subsidiaries of the Group which engages in the internet finance business. Such amounts are recorded at the principal amount less allowance for doubtful accounts. The loan periods granted by the Group to the individuals generally range from 3 months to 12 months. Loan receivables are mainly denominated in RMB.

Detail of the credit risk assessment of loan receivables is disclosed in Note 3.1.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in RMB unless otherwise indicated)

21 Trade receivables

Trade receivables analysis is as follows:

	As of December 31, 2018 RMB'000	2017 RMB'000
Third parties	5,302,432	5,337,711
Related parties	364,608	188,616
	5,667,040	5,526,327
Less: allowance for impairment	(68,597)	(56,820)
	5,598,443	5,469,507

The carrying amounts of the Group's trade receivables are denominated in the following currencies:

	As of December 31, 2018 RMB'000	2017 RMB'000
RMB	3,285,845	2,787,885
INR	1,464,621	2,389,901
US$	795,971	264,912
Others	52,006	26,809
	5,598,443	5,469,507

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

21 Trade receivables (continued)

Movements on the Group's allowance for impairment of trade receivables are as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	(56,820)	(40,048)
Provision for doubtful receivables	(19,451)	(24,467)
Reversal of provision for previous impaired receivables	7,674	7,502
Receivables written off during the year as uncollectable	—	193
At the end of the year	(68,597)	(56,820)

(a) The Group generally allows a credit period within 180 days to its customers. Aging analysis of trade receivables based on invoice date is as follows:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Trade receivables		
Up to 3 months	5,094,390	5,099,590
3 to 6 months	392,868	302,354
6 months to 1 year	116,279	39,028
1 to 2 years	16,630	53,613
Over 2 years	46,873	31,742
	5,667,040	5,526,327

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

21 Trade receivables (continued)

(b) The Group applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which permits the use of the lifetime expected loss provision for all trade receivables. To measure the expected credit losses, trade receivables have been grouped based on shared credit risk characteristics and the days past due. The expected credit losses below also incorporate forward looking information. The loss allowance provisions as of December 31, 2018 and 2017 are determined as follows:

	Current	Up to 3 months past due	3 to 6 months past due	Over 6 months past due	Total
December 31, 2018:					
Expected loss rate	0.01%	0.99%	34.22%	52.85%	
Gross carrying amount (in thousand)	4,992,793	532,901	64,006	77,340	5,667,040
Loss allowance provision (in thousand)	562	5,261	21,902	40,872	68,597
December 31, 2017:					
Expected loss rate	0.01%	0.96%	37.27%	41.59%	
Gross carrying amount (in thousand)	4,951,616	444,031	50,435	80,245	5,526,327
Loss allowance provision (in thousand)	383	4,270	18,797	33,370	56,820

As of December 31, 2018 and 2017, the majority of the balance of receivables are due from certain channel distributors and customers in mainland China and India who usually settle the amounts due by them within 180 days.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

22 Prepayments and other receivables

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Receivables from subcontractors for outsourcing of raw materials and amounts paid for third parties	10,043,378	5,663,419
Recoverable value-added tax and other taxes	7,811,161	3,387,401
Prepayments to suppliers	467,418	304,286
Deposits to suppliers	569,598	96,913
Receivables from market development fund	822,809	199,751
Prepaid fees for establishing loan facilities and other prepaid expenses	228,197	195,592
Receivables from import and export agents	52,263	644,766
Receivables from employees related to Employee Fund (Note (a))	110,950	114,850
Interest receivables	231,819	104,521
Receivables from disposal of investments	35,226	108,056
Loans to related parties (Note (b))	7,979	62,143
Others	534,148	512,212
	20,914,946	11,393,910

Notes:

(a) Receivables from employees related to Employee Fund is interest bearing and repayable when the employee resign from the Group. Further detail included in Note 28.

(b) Loans to related parties were unsecured, repayable on demand and carried interest rate at ceiling of 8% per annum (2017: 8%).

As of December 31, 2018 and 2017, the carrying amounts of other receivables were primarily denominated in RMB and US$ and approximated their fair value at each of the reporting dates. Other receivables that are measured at amortized costs included receivables from subcontractors for outsourcing of raw materials and amounts paid for third parties, receivables from import and export agents, receivables from market development fund, receivables from employees related to Employee Fund, receivables from disposal of investments, interest receivables, loans to related parties and others were considered to be of low credit risk, and thus the impairment provision recognized during the year ended December 31, 2018 and 2017 was limited to 12 months expected losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

23 Inventories

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Raw materials	7,343,118	5,117,285
Finished goods	19,112,105	8,461,798
Work in progress	2,068,834	1,352,886
Spare parts	1,156,825	1,569,040
Others	1,651,854	510,061
	31,332,736	17,011,070
Less: provision for impairment (Note (a))	(1,852,051)	(668,142)
	29,480,685	16,342,928

Note:

(a) Provision for impairment was recognized for the amount by which the carrying amount of the inventories exceeds its net realizable value, and was recorded in "cost of sales" in the consolidated income statement. The provision for impairment expense of inventory amounted to RMB3,006,525,000 for the year ended December 31, 2018 (2017: RMB652,560,000).

Provision for impairment movements for the years ended December 31, 2018 and 2017 are as below:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	(668,142)	(283,159)
Provision for impairment	(3,006,525)	(652,560)
Transfer to cost of sales upon sold	1,822,616	267,577
At the end of the year	(1,852,051)	(668,142)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

24 Cash and bank balances

(a) Cash and cash equivalents

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Cash at bank and in hand	10,958,910	7,598,660
Short-term bank deposits with initial terms within three months	19,271,237	3,964,622
	30,230,147	11,563,282

Cash and cash equivalents are denominated in the following currencies:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
US$	22,189,594	3,625,567
RMB	7,192,491	5,372,675
INR	532,838	2,384,434
Others	315,224	180,606
	30,230,147	11,563,282

The weighted average effective interest rate for the short-term bank deposits with initial terms within three months was 3.24% per annum for the year ended December 31, 2018 (2017: 2.78%).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

24 Cash and bank balances (continued)

(b) Restricted cash

As of December 31, 2018, among of the restricted cash, RMB1,083,723,000 was held at bank to meet requirements of People's Bank of China for reserves of payment institutions. US$20,000,000 (equivalent to approximately RMB137,264,000) was held at the Agricultural Bank of China as guarantee for purchase contract with Samsung.

(c) Short-term bank deposits

An analysis of the Group's short-term bank deposits as of December 31, 2018 and 2017 are listed as below:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Short-term bank deposits denominated in RMB	**460,000**	20,000
Short-term bank deposits denominated in INR	**49**	205,146
Short-term bank deposits denominated in US$	**905,942**	—
	1,365,991	225,146

Short-term bank deposits are bank deposits with original maturities over three months and redeemable on maturity.

The effective interest rate of the short-term bank deposits of the Group ranges from 2.25% to 6.00% per annum for the year ended December 31, 2018 (2017: from 2.25% to 7.45%).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

25 Share capital

Authorized:

	Note	Number of ordinary shares '000	Nominal value of ordinary shares US$'000	Number of Preferred Shares '000	Nominal value of Preferred Shares US$'000
As of January 1, 2017		3,489,594	87	1,050,755	26
Issuance of Series F1 Preferred Shares		—	—	496	—
As of December 31, 2017		3,489,594	87	1,051,251	26
Effect of Share Subdivision	(a)	31,406,344	—	9,461,254	—
Conversion of Preferred Shares to ordinary shares	(b)	10,512,505	26	(10,512,505)	(26)
Increase of authorized ordinary shares	(c)	224,591,557	561	—	—
As of December 31, 2018		270,000,000	674	—	—

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

25 Share capital (continued)

Issued:

	Note	Number of ordinary shares '000	Nominal value of ordinary shares US$'000	Equivalent nominal value of ordinary shares RMB'000	Share premium RMB'000
As of January 1, 2017 and December 31, 2017		978,217	24	150	742,760
Acquisition of additional equity interests in non-wholly owned subsidiaries	(d)	1,500	—	—	230,899
Issuance of ordinary shares	(e)	63,960	2	11	9,827,146
Effect of Share Subdivision	(a)	9,393,092	—	—	—
Issuance of ordinary shares relating to initial public offering, net of underwriting commissions and other issuance costs	(f)	1,635,926	4	27	23,248,593
Conversion of Preferred Shares to ordinary shares	(b)	10,504,922	26	174	151,100,334
Release of ordinary shares from Share Scheme Trusts	(g)	—	2	15	933,592
Issuance of ordinary shares to Share Scheme Trusts	(g)	1,048,806	—	—	—
Share premium set off the accumulated losses and other reserves	(h)	—	—	—	(142,232,042)
As of December 31, 2018		**23,626,423**	**58**	**377**	**43,851,282**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

25 Share capital (continued)

Notes:

(a) On June 17, 2018, pursuant to the shareholders' resolution, each existing issued and unissued share of US$0.000025 each in the share capital of the Company were subdivided into 10 shares of US$0.0000025 each.

(b) Upon completion of the IPO, each issued Preferred Share converted into one Class B ordinary share by re-designation and reclassification of every Preferred Share in issue as an Class B ordinary share on a one for one basis and all the unissued and authorized Preferred Shares were re-designated and reclassified as Class B ordinary shares. As a result, the financial liabilities for Preferred Shares were derecognized and recorded as share capital and share premium.

(c) Upon completion of the re-designation and reclassification noted in (b), the authorized share capital of the Company increased 63,116,143,000 Class A ordinary shares of nominal value of US$0.0000025 each and 161,475,414,000 Class B ordinary shares of nominal value of US$0.0000025 each.

(d) Pursuant to the shareholders' resolution passed on March 30, 2018, 1,500,000 Class B ordinary shares (or 15,000,000 Class B ordinary shares following the Share Subdivision) were issued as consideration shares in exchange for certain indirect equity interests in subsidiary Timi Personal Computing Co., Ltd (Note 12(a)).

(e) On April 2, 2018, the Company issued 63,959,619 Class B ordinary shares (or 639,596,190 Class B ordinary shares following the Share Subdivision) at par value to Smart Mobile Holdings Limited, an entity whose interest is held on trust for the benefit of Lei Jun and his family members, to reward Lei Jun for his contribution to the Company. Accordingly, RMB9,827,157,000 was recognized as share-based compensation expenses on April 2, 2018 by the Group.

(f) Upon completion of the IPO, the Company issued 1,635,926,000 new shares at par value of US$0.0000025 each for cash consideration of HK$17.00 each, and raised gross proceeds of approximately HK$27,810,742,000 (equivalent to RMB23,525,107,000). The respective share capital amount was approximately RMB27,000 and share premium arising from the issuance was approximately RMB23,248,593,000, net of the share issuance costs. The share issuance costs paid and payable mainly include share underwriting commissions, lawyers' fees, reporting accountant's fee and other related costs, which are incremental costs directly attributable to the issuance of the new shares. These costs amounting to RMB276,487,000 were treated as a deduction against the share premium arising from the issuance.

(g) During the year ended December 31, 2018, the Company issued ordinary shares with respect to the share options under the share option scheme exercised by certain grantees of the Company before December 31, 2018 to trusts, which were established to hold the shares for and on behalf of the grantees (collectively, "**Share Scheme Trusts**").

(h) On December 27, 2018, the Board of Directors passed a resolution that the sum of approximately of RMB142,232,042,000 standing to the credit of the share premium account of the Company was applied to set off the accumulated losses and other reserves of the Company. The accumulated losses of RMB136,652,570,000 was set off and the related currency translation difference of RMB5,579,472,000 was released.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

26 Other reserves

	Share-based compensation reserve RMB'000	Currency translation differences RMB'000	Statutory surplus reserve RMB'000	Capital reserve RMB'000	Others RMB'000	Total RMB'000
At January 1, 2018	3,816,153	(3,779,938)	805,180	33,501	72,524	947,420
Appropriation to statutory reserves (Note (a))	—	—	57,808	—	—	57,808
Employees share-based compensation scheme:						
— value of employee services (Note (c) and Note 28)	2,358,720	—	—	—	—	2,358,720
Share of other comprehensive income of investments accounted for using the equity method (Note 12(b))	—	—	—	—	191,449	191,449
Share of other reserves of investments accounted for using the equity method (Note 12(b))	—	—	—	62,657	—	62,657
Acquisition of additional equity interests in non-wholly owned subsidiaries	—	—	—	(152,071)	—	(152,071)
Currency translation differences (Note (b))	—	(1,756,092)	—	—	—	(1,756,092)
Share premium set off the accumulated losses and other reserves (Note 25(h))	—	5,579,472	—	—	—	5,579,472
Release of ordinary shares from Share Scheme Trusts (Note 25(g))	(841,640)	—	—	—	—	(841,640)
Others	—	—	(308)	—	—	(308)
At December 31, 2018	5,333,233	43,442	862,680	(55,913)	263,973	6,447,415

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

26 Other reserves (continued)

	Share-based compensation reserve RMB'000	Currency translation differences RMB'000	Statutory surplus reserve RMB'000	Capital reserve RMB'000	Others RMB'000	Total RMB'000
At January 1, 2017	3,008,259	(11,706,613)	478,730	(38)	95,307	(8,124,355)
Appropriation to statutory reserves (Note (a))	–	–	326,450	–	–	326,450
Employees share-based compensation scheme:						
— value of employee services (Note (c) and Note 28)	807,894	–	–	–	–	807,894
Share of other comprehensive loss of investments accounted for using the equity method (Note 12(b))	–	–	–	–	(22,783)	(22,783)
Share of other reserves of investments accounted for using the equity method (Note 12(b))	–	–	–	33,539	–	33,539
Currency translation differences (Note (b))	–	7,926,675	–	–	–	7,926,675
At December 31, 2017	3,816,153	(3,779,938)	805,180	33,501	72,524	947,420

Notes:

(a) In accordance with the Company Law of the People's Republic of China and the stipulated provisions of the articles of association of subsidiaries with limited liabilities in mainland China, appropriation of net profits (after offsetting accumulated losses from prior years) should be made by these companies to their respective statutory surplus reserve funds and discretionary reserve funds before distributions are made to the owners. The percentage of appropriation to statutory surplus reserve fund is 10%. The amount to be transferred to discretionary reserve fund is determined by the equity owners of these companies. When the balance of the statutory surplus reserve fund reaches 50% of the registered capital, such transfer needs not to be made. Both statutory surplus reserve fund and discretionary reserves fund can be capitalized as capital of an enterprise, provided that the remaining statutory surplus reserve fund shall not be less than 25% of the registered capital.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

26 Other reserves (continued)

Notes (continued):

In addition, in accordance with the Law of the People's Republic of China on Enterprises with Foreign Investments and the stipulated provisions of the articles of association of wholly owned foreign subsidiaries in mainland China, appropriation from net profits (after offsetting accumulated losses brought forward from prior years) should be made by these companies to their respective reserve fund. The percentage of net profit to be appropriated to the reserve fund is not less than 10% of the net profit. When the balance of the reserve fund reaches 50% of the registered capital, such transfer needs not be made. With approvals obtained from respective boards of directors of these companies, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

(b) Foreign currency translation reserve represents the difference arising from the translation of the financial statements of companies within the Group that have a functional currency different from the presentation currency of RMB for the financial statements of the Company and the Group.

A majority of the currency translation differences are arising from the Company when it translates the financial statements from the functional currency of US$ to presentation currency of RMB.

(c) Share-based compensation reserve arises from share-based payments granted to employees of the Group, see Note 28 for detail.

27 Dividends

No dividends have been paid or declared by the Company during the years ended December 31, 2018 and 2017.

28 Share-based payments

On May 5, 2011, the Board of Directors of the Company approved the establishment of the "Xiaomi Corporation 2011 Employee Stock Option Plan" ("**2011 Plan**") with the purpose of attracting, motivating, retaining and rewarding certain employees and directors. The 2011 Plan is valid and effective for 10 years from the approval of the Board of Directors. The maximum number of shares that may be issued under 2011 Plan shall be 35,905,172 Class B ordinary shares (which were adjusted to 1,436,206,880 shares after the 1 to 4 share split on March 14, 2014 and further 1 to 10 Share Subdivision on June 17, 2018). The 2011 Plan permits the awards of options and RSUs.

Subsequently in August 2012, the 2011 Plan was superseded in its entirety as the "2012 Employee Stock Incentive Plan" ("**Pre-IPO ESOP**"). The purpose of Pre-IPO ESOP is same as the 2011 Plan. The Pre-IPO ESOP is valid and effective for 10 years from the approval of the Board of Directors. Through Pre-IPO ESOP, the Company may grant equity-based incentive up to 45,905,172 Class B ordinary shares initially (which were adjusted to 1,836,206,880 shares after the 1 to 4 share split on March 14, 2014 and further 1 to 10 Share Subdivision on June 17, 2018). The aggregate number of reserved Class B ordinary shares approved was 2,512,694,900 and 251,307,455 (which were adjusted to 2,513,074,550 shares after the Share Subdivision on June 17, 2018) as of December 31, 2018 and 2017, respectively. The Pre-IPO ESOP permits the awards of options and RSUs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

On June 17, 2018, the Board of Directors of the Company adopted the principal terms of the Post-IPO Share Option Scheme ("Post-IPO ESOP"). The purpose of Post-IPO ESOP is to provide selected participants with the opportunity to acquire proprietary interests in the Company and to encourage selected participants to work towards enhancing the value of the Company and its shares for the benefit of the Company and its shareholders as a whole. The total number of Class B ordinary shares available for grant under Post-IPO ESOP was 2,237,613,083 Class B ordinary shares. As of December 31, 2018, no option has been granted or agreed to be granted pursuant to Post-IPO ESOP.

Upon the Share Subdivision became effective, pro-rata adjustments have been made to the number of outstanding awarded shares, so as to give the participants the same proportion of the equity capital as that they were entitled to before the effect of the Share Subdivision. However, the number of share options, average exercise price per share option, fair value of share options, key assumptions of fair value of share options, number of RSUs and weighted average grant date fair value per RSU stated below were before the adjustment for the Share Subdivision.

Share options granted to employees

The share options have graded vesting terms, and vest in different schedules from the grant date over one year, 2 years, 4 years, 5 years and 10 years, on condition that employees remain in service without any performance requirements. For vesting schedule as one year, all granted share options are vested on the first anniversary of the grant date. For vesting schedule as 2 years, 50% of the aggregate number of granted share options are vested on the first anniversary of the grant date, and remaining granted share options are vested in equal tranches every month over the next twelve months. For vesting schedule as 4 years, 50% of granted share options are vested on the second anniversary of the grant date, 25% of granted share options are vested on the third anniversary of the grant date, the remaining granted share options are vested on the fourth anniversary of the grant date. For vesting schedule as 5 years, 40% of granted share options are vested on the second anniversary of the grant date, and every 20% of granted share options are vested on the third, fourth and fifth anniversary of the grant date respectively. For vesting schedule as 10 years, the granted share options are vested through 10 years with 6% to 15% shares vested each year unequally.

Under Pre-IPO ESOP, the Company also granted performance-based share options to certain employees, which are generally vested over a 10-year term. The performance goals are determined by the Board of Directors. For those awards, evaluations are made as of each reporting period to assess the likelihood of performance criteria being met. Share-based compensation expenses are then adjusted to reflect the revision of original estimates.

The options may be exercised at any time and from time to time only after the closing of the QPO or upon the approval of Board of Directors for all or any portion of the share options that have become vested.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

Share options granted to employees (continued)

Movements in the number of share options granted to employees and their related weighted average exercise prices are as below:

	Number of share options	Average exercise price per share option (US$)
Outstanding as of January 1, 2018 (Note (a))	**189,755,311**	**1.05**
Granted during the year (Note (a))	**42,500,561**	**1.98**
Forfeited during the year (Note (a))	**(3,857,990)**	**3.26**
Transferred to Share Scheme Trusts (Note (a), Note 25(g))	**(85,038,091)**	**1.58**
Effect of Share Subdivision (Note (b))	**1,290,238,122**	**—**
Outstanding as of December 31, 2018	**1,433,597,913**	**0.10**
Exercisable as of December 31, 2018	**703,071,315**	**0.09**
Outstanding as of January 1, 2017 (Note (a))	162,831,760	0.88
Granted during the year (Note (a))	31,940,400	2.26
Forfeited during the year (Note (a))	(5,016,849)	3.07
Outstanding as of December 31, 2017	189,755,311	1.05
Exercisable as of December 31, 2017	146,410,089	0.37

Notes:

(a) The numbers of shares were presented as before the effect of the Share Subdivision.

(b) It represented the effects of adjustments made to the numbers of shares as a result of the Share Subdivision.

The weighted-average remaining contract life for outstanding share options was 6.60 years as of December 31, 2018 (2017: 5.17 years).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

Fair value of share options

Prior to the completion of IPO on July 9, 2018, the Group has used the discounted cash flow method to determine the underlying equity fair value of the Company and adopted equity allocation model to determine the fair value of the underlying ordinary shares. Key assumptions, such as discount rate and projections of future performance, are determined by the Group with best estimate.

Based on fair value of the underlying ordinary shares, the Group has used Binomial option-pricing model to determine the fair value of the share option as of the grant date. Key assumptions are set as below:

	Year ended December 31,	
	2018	2017
Fair value per share (Note (a))	**US$22.99–24.48**	US$13.93–22.25
Exercise price (Note (a))	**US$1.02–3.44**	US$0–3.44
Risk-free interest rate	**3.12%–3.68%**	2.88%–3.22%
Dividend yield	**—**	—
Expected volatility	**41.57%–43.21%**	42.70%–44.20%
Expected terms	**10 years**	10 years

Note:

(a) The fair value per share and the exercise price presented were before the effect of the Share Subdivision.

The weighted-average fair value of granted shares was US$21.80 (which was adjusted to US$2.18 after the Share Subdivision on June 17, 2018) per share for the year ended December 31, 2018 (2017: US$16.33 (which was adjusted to US$1.63 after the Share Subdivision on June 17, 2018)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

RSUs granted to employees

The Company also granted RSUs to the Company's employees under Pre-IPO ESOP. The RSUs granted would vest on the second anniversary from the grant date, and in equal tranches over the remaining years of total vesting period as four or five years, on condition that employees remain in service without any performance requirements.

The RSUs may be settled at any time and from time to time only after the closing of the QPO or upon the approval of Board of Directors for all or any portion of the RSUs that have become vested.

Movements in the number of RSUs granted to the Company's employees and the respective weighted-average grant date fair value are as follows:

	Number of RSUs	Weighted average grant date fair value per RSU (US$)
Outstanding as of January 1, 2018 (Note (a))	24,492,747	2.94
Granted during the year (Note (a))	—	—
Forfeited during the year (Note (a))	(3,776,549)	6.36
Effect of Share Subdivision (Note (b))	186,445,782	—
Outstanding as of December 31, 2018	207,161,980	0.23
Vested as of December 31, 2018	206,921,978	0.23
Outstanding as of January 1, 2017 (Note (a))	41,094,870	4.84
Granted during the year (Note (a))	500,000	14.73
Forfeited during the year (Note (a))	(17,102,123)	7.85
Outstanding as of December 31, 2017	24,492,747	2.94
Vested as of December 31, 2017	22,209,185	2.46

Notes:

(a) The numbers of shares were presented as before the effect of the Share Subdivision.

(b) It represented the effects of adjustments made to the numbers of shares as a result of the Share Subdivision.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

RSUs granted to employees (continued)

The weighted-average remaining contract life for outstanding RSUs was 4.26 years as of December 31, 2018 (2017: 5.48 years).

Prior to the completion of IPO on July 9, 2018, the Group has used the discounted cash flow method to determine the underlying equity fair value of the Company and adopted equity allocation model to determine the fair value of the underlying ordinary share. Key assumptions, such as discount rate and projections of future performance, are required to be determined by the Group with best estimate.

The fair value of each RSU at the grant dates were determined by reference to the fair value of the ordinary shares of the Company that issued to its shareholders.

The total expenses recognized in the consolidated income statement for aforementioned share-based awards granted to the Group's employees are RMB2,358,917,000 for the year ended December 31, 2018 (2017: RMB807,894,000).

Share based awards granted to Lei Jun

On April 2, 2018, the Company issued 63,959,619 Class B ordinary shares (or 639,596,190 Class B ordinary shares following the Share Subdivision) at par value to Smart Mobile Holdings Limited, an entity whose interest is held on trust for the benefit of Lei Jun and his family members, to reward Lei Jun for his contribution to the Company. Accordingly, RMB9,827,157,000 was recognized as share-based compensation expenses on April 2, 2018 by the Group.

On June 17, 2018, Lei Jun was granted 42,070,000 share options in Xiaomi Finance pursuant to the first share option scheme adopted by Xiaomi Finance. Such share options were vested immediately and Lei Jun can exercise these share options with exercise price of RMB3.8325 for each share option for the following 20 years commencing on June 17, 2018. Based on fair value of the underlying ordinary shares, the Group has used Binomial option-pricing model to determine the fair value of the share option as the grant date. Key valuation assumptions include discount rate (post-tax) of 18.5%, risk-free interest rate of 3.99%, volatility of 46%. Accordingly, RMB102,608,000 was recognized as share-based compensation expenses on June 17, 2018 by the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

28 Share-based payments (continued)

Employee fund

On August 31, 2014, the Board of Directors of the Company approved the establishment of Employee Fund with the purpose of which is to invest in companies within the business ecosystem of the Group. The Company invited certain employees to participate, with the condition that they would only receive the original investment sum with interest should they decide to resign from the Group within 5 years from the investment date (the "**Lockup Period**"). Upon the end of the Lockup Period, the holders would become the equity holders of the Employee Fund. Thereafter when the employees decide to resign after Lockup Period, the employees can demand the Company to buy back the shares at fair value or continue to hold the shares. Accordingly, the Group granted compound financial instruments to its employees and accounted for it as equity-settled share-based payments and cash-settled share-based payments.

The total expenses recognized in the consolidated income statement for the Employee Fund granted to the Group's employees are RMB91,986,000 for the year ended December 31, 2018 (2017: RMB101,261,000).

29 Other non-current liabilities

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Investment from fund investors (Note (a))	**2,823,504**	—
Others	**21,355**	35,211
	2,844,859	35,211

Note:

(a) It represents the funds raised by the third party investors under the Hubei Fund (Note 12(a)). The Group controls the Hubei Fund as the Group is exposed to and has rights to variable returns from its involvement with the Hubei Fund and has the ability to affect those returns through its power over the Hubei Fund. Hubei Fund has limited operation during the current period. For the amount raised from limited partners, the Group has contractual obligation to settle the liability with the limited partners and therefore is classified as a financial liability measured at amortized cost in the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

30 Trade payables

Trade payables primarily include payables for inventories and royalty fees. As of December 31, 2018 and 2017, the carrying amounts of trade payables were primarily denominated in RMB, US$ and INR.

Trade payables and their aging analysis based on invoice date are as follows:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Up to 3 months	44,312,748	32,859,302
3 to 6 months	1,656,699	936,690
6 months to 1 year	266,623	180,060
1 to 2 years	50,350	22,525
Over 2 years	851	4,754
	46,287,271	34,003,331

31 Other payables and accruals

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Amounts collected for third parties	1,628,230	1,056,228
Payroll and welfare payables	795,593	694,887
Deposits payable	953,132	678,472
Employee Fund (Note 28)	553,108	469,930
Accrual expenses	499,295	373,034
Payables for construction cost	619,935	241,881
Payables for investments	222,382	151,712
Loans from related parties	—	51,336
Other taxes payables	192,182	59,431
Others	848,913	447,068
	6,312,770	4,223,979

The carrying amounts of other payables were primarily denominated in RMB and approximate their fair values as of December 31, 2018 and 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

32 Advance from customers

Advance from customers primarily includes advance from customers when the Group receives payments in advance of the delivery of products or performance of services.

33 Borrowings

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Included in non-current liabilities		
Asset-backed securities (Note (a))	2,752,815	2,400,105
Fund raised through trusts (Note (b))	—	400,000
Secured borrowings (Note (c))	1,260,941	714,107
Unsecured borrowings (Note (d))	3,842,387	3,737,100
	7,856,143	7,251,312
Included in current liabilities		
Asset-backed securities (Note (a))	586,282	1,491,147
Fund raised through trusts (Note (b))	648,390	1,170,250
Pledged borrowings	—	729,404
Unsecured borrowings (Note (d))	1,840,522	160,000
	3,075,194	3,550,801

Notes:

(a) The Group has securitized certain loan receivables and completed several rounds of issuance of its asset-backed securities ("**ABS**"). As of December 31, 2018, the total ABS amounting to RMB3,339,097,000 (2017: RMB3,891,252,000) bore interest at 5.1%–8.0% per annum in 2018 (2017: 5.3%–8.8%).

(b) The Group has securitized certain loan receivables and raised several rounds of funds through third party trusts. As of December 31, 2018, the fund raised through trusts amounting to RMB648,390,000 (2017: RMB1,570,250,000) bore interest at 6.1%–6.2% per annum in 2018 (2017: 5.2%–9.0%). The Group is committed to unconditionally repurchase the aforementioned securitized loan receivables. The balance will mature in 2019.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

33 Borrowings (continued)

Notes (continued):

(c) As of December 31, 2018, RMB1,260,941,000 (2017: RMB714,107,000) of long-term borrowings were secured by construction in progress and land use rights amounting to approximately RMB4,082,853,000 (2017: RMB3,579,363,000). The interest rate of these borrowings was 4.655%–4.900% per annum (2017: 4.655%–4.900%). These borrowings should be repaid by the Group by the end of September 27, 2032.

(d) As of December 31, 2018, the Group had (i) US$500,000,000 (equivalent to approximately RMB3,431,600,000) unsecured borrowings relating to a three-year bank loan facility agreement entered into on July 26, 2017 with the available commitment US$1,000,000,000 (equivalent to approximately RMB6,863,200,000) including US$500,000,000 (equivalent to approximately RMB3,431,600,000) term loan and US$500,000,000 (equivalent to approximately RMB3,431,600,000) revolving loan, which should be repaid by the Group on July 25, 2020; (ii) RMB815,408,000 (2017: Nil) unsecured borrowings with interest rate 4.568% per annum and RMB55,114,000 (2017: Nil) unsecured borrowings with interest rate 4.568%-8.500% per annum, which should be repaid by the Group in 2019; (iii) RMB470,000,000 (2017: RMB490,000,000) unsecured borrowings with interest rate 4.750% per annum, of which RMB20,000,000 (2017: RMB20,000,000) should be repaid by the Group within the next twelve months and RMB450,000,000 (2017: RMB470,000,000) should be repaid by the Group by March 1, 2022; and (iv) unsecured borrowings of RMB450,000,000 (2017: RMB140,000,000) with interest rate 6.960% per annum (2017: 5.8725%) and RMB500,000,000 (2017: Nil) with interest rate of 6.960% per annum, which should be repaid by the Group in 2019.

For the year ended December 31, 2018, the annual interest rate of the interest-bearing liabilities ranges from 2.22% to 9.00% per annum (2017: from 2.22% to 9.00%).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

34 Deferred income taxes

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rates at which are expected to be applied at the time of reversal of the temporary differences.

The amount of offsetting deferred income tax assets and liabilities is RMB93,750,000 as of December 31, 2018 (2017: RMB129,813,000). The analysis of deferred income tax assets and liabilities before offsetting is as follows:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Deferred income tax assets:		
— to be recovered after 12 months	625,671	221,133
— to be recovered within 12 months	780,324	500,256
	1,405,995	721,389
Deferred income tax liabilities:		
— to be settled after 12 months	(870,082)	(1,147,770)
— to be settled within 12 months	(1,313)	(694)
	(871,395)	(1,148,464)

The gross movement on the deferred income tax assets is as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	721,389	488,054
Credited to the consolidated income statement	684,606	233,335
At the end of the year	1,405,995	721,389

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

34 Deferred income taxes (continued)

The gross movement on the deferred income tax liabilities is as follows:

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
At the beginning of the year	(1,148,464)	(500,040)
Credited/(debited) to the consolidated income statement	280,619	(648,424)
Acquisition of a subsidiary	(3,550)	—
At the end of the year	(871,395)	(1,148,464)

34 Deferred income taxes (continued)

The movement in deferred income tax assets and liabilities during the years without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

Deferred income tax assets:

	Accrued liabilities and provisions RMB'000	Provision for impairment of inventories RMB'000	Depreciation of property and amortization of intangible assets RMB'000	Tax losses RMB'000	Fair value changes of financial assets RMB'000	Provision for impairment of receivables RMB'000	Unrealized gain on intra-group transactions RMB'000	Others RMB'000	Total RMB'000
At January 1, 2018	267,649	148,193	93,119	62,019	55,991	41,186	44,696	8,536	721,389
(Debited)/credited to consolidated income statement	(36,189)	237,176	558	297,180	24,350	51,775	111,744	(1,988)	684,606
At December 31, 2018	231,460	385,369	93,677	359,199	80,341	92,961	156,440	6,548	1,405,995
At January 1, 2017	276,035	66,722	93,474	–	24,643	1,015	5,540	20,625	488,054
(Debited)/credited to consolidated income statement	(8,386)	81,471	(355)	62,019	31,348	40,171	39,156	(12,089)	233,335
At December 31, 2017	267,649	148,193	93,119	62,019	55,991	41,186	44,696	8,536	721,389

Deferred income tax assets are recognized for deductible temporary differences to the extent that the realization of the related tax benefits through future taxable profits is probable.

As of December 31, 2018, the Group did not recognize deferred income tax assets of RMB520,995,000 (2017: RMB521,499,000), in respect of deductible temporary differences and cumulative tax losses amounting RMB2,293,425,000 (2017: RMB2,330,552,000), that can be carried forward against future taxable income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

34 Deferred income taxes (continued)

Deferred income tax liabilities:

	Changes in fair value of financial assets RMB'000	Business combination RMB'000	Total RMB'000
At January 1, 2018	(1,147,419)	(1,045)	(1,148,464)
Credited to consolidated income statement	279,038	1,581	280,619
Acquisition of a subsidiary	—	(3,550)	(3,550)
At December 31, 2018	(868,381)	(3,014)	(871,395)
At January 1, 2017	(498,200)	(1,840)	(500,040)
(Debited)/credited to consolidated income statement	(649,219)	795	(648,424)
At December 31, 2017	(1,147,419)	(1,045)	(1,148,464)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares

Since the date of incorporation, the Company has completed several rounds of financing by issuing Preferred Shares. For details, please refer to below table:

		Purchase Price (US$/Share)		Number of Shares		Total Consideration	
	Date of Issuance	Before the Share Split on March 14, 2014 (Note (a))	After the Share Split on March 14, 2014	Before the Share Split on March 14, 2014	After the Share Split on March 14, 2014	US$	RMB
Series A Preferred Shares	September 28, 2010	0.1000	0.0250	100,000,000	400,000,000	10,000,000	67,051,000
Series A Preferred Shares	December 21, 2010	0.1000	0.0250	2,500,000	10,000,000	250,000	1,665,000
Series B1 Preferred Shares	December 21, 2010	0.4113	0.1028	60,775,862	243,103,448	25,000,000	166,493,000
Series B2 Preferred Shares	December 21, 2010	0.5818	0.1454	4,297,283	17,189,132	2,500,000	16,650,000
Series B+ Preferred Shares	April 11, 2011	0.5818	0.1454	4,727,011	18,908,044	2,750,000	17,371,000
Series B++ Preferred Shares	August 24, 2011	0.5818	0.1454	1,031,347	4,125,388	600,000	3,834,000
Series C Preferred Shares	September 30, 2011	2.0942	0.5236	21,010,411	84,041,644	44,000,000	279,616,000
Series C+ Preferred Shares	November 10, 2011	2.0942	0.5236	1,002,765	4,011,060	2,100,000	13,299,000
Series C Preferred Shares	March 29, 2012	2.0942	0.5236	21,010,411	84,041,644	44,000,000	276,901,000
Series D Preferred Shares	June 22, 2012	8.1882	2.0471	13,189,777	52,759,108	108,000,000	680,835,000
Series D Preferred Shares	December 21, 2012	8.1882	2.0471	13,189,777	52,759,108	108,000,000	679,118,000
Series E1 Preferred Shares	August 5, 2013	15.0392	3.7598	5,319,419	21,277,676	80,000,000	494,139,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares (continued)

		Purchase Price (US$/Share)		Number of Shares		Total Consideration	
	Date of Issuance	Before the Share Split on March 14, 2014 (Note (a))	After the Share Split on March 14, 2014	Before the Share Split on March 14, 2014	After the Share Split on March 14, 2014	US$	RMB
Series E2 Preferred Shares	August 5, 2013	18.7614	4.6904	1,066,016	4,264,064	20,000,000	123,534,000
Series F1 Preferred Shares	December 23, 2014	NA	20.1682	NA	37,226,830	750,800,000	4,597,137,000
Series F2 Preferred Shares	December 23, 2014	NA	17.9273	NA	8,376,037	150,160,000	919,430,000
Series F1 Preferred Shares	March 25, 2015	NA	20.1682	NA	1,147,843	23,150,000	144,252,000
Series F1 Preferred Shares	July 3, 2015	NA	20.1682	NA	9,916,601	200,000,000	1,246,240,000
Series F1 Preferred Shares	August 24, 2017	NA	20.1682	NA	495,830	10,000,000	67,573,000

Notes:

(a) Pursuant to the shareholders' resolution passed on March 14, 2014, every share of the issued convertible redeemable preferred shares is subdivided into four shares.

(b) Series B Preferred Shares includes Series B1 Preferred Shares, Series B2 Preferred Shares, Series B+ Preferred Shares and Series B++ Preferred Shares; Series C Preferred Shares includes Series C Preferred Shares and Series C+ Preferred Shares; Series E Preferred Shares includes Series E1 Preferred Shares and Series E2 Preferred Shares; Series F Preferred Shares includes Series F1 Preferred Shares and Series F2 Preferred Shares.

(c) Following the Share Subdivision as detailed in Note 25, each of convertible redeemable preferred share was further subdivided into 10 shares. However, the purchase price and number of shares stated above were not adjusted for the effect of the Share Subdivision.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares (continued)

The key terms of the Preferred Shares are summarized as follows:

(a) Dividends rights

Each holder of Preferred Shares shall be entitled to receive from the Company on the preferential basis, out of funds legally available therefore, non-cumulative dividends per Preferred Share held by such holder accrued at the rate of eight percent (8%) of the applicable original issue price per annum (as adjusted for any stock dividends, combinations or splits with respect to such shares), when and if declared by the board, prior and in preference to holders of all other current or future class or series of shares of the Company, including the ordinary shares. No dividend, whether in cash, in property or in shares of the capital of the Company, shall be paid on or declared and set aside for any ordinary shares or any other class or series of shares of the Company unless and until all dividends have been paid in full on the Preferred Shares (on an as-converted basis).

(b) Conversion feature

The Preferred Shares shall be converted into Class B ordinary shares at the option of holders at any time after July 3, 2015, or automatically converted into Class B ordinary shares at the then effective applicable conversion price upon (i) the closing of a QPO, or (ii) with written consent of holders of more than fifty percent (50%) of the issued and outstanding Series A Preferred Shares, or written consent of holders of more than two thirds (2/3) of the issued and outstanding Preferred Shares (other than Series A Preferred Shares), respectively. In the event of the automatic conversion of the Preferred Shares, the person(s) entitled to receive the Class B ordinary shares issuable upon such conversion of Preferred Shares shall not be deemed to have converted such Preferred Shares until immediately prior to the closing of such transaction.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares (continued)

(b) Conversion feature (continued)

QPO means a firm underwritten public offering of the ordinary shares or other equity securities of the Company (or as the case may be, the shares or other equity securities of the relevant entity resulting from any merger, reorganization or other arrangements made by or to the Company for the purposes of a firm underwritten public offering) on the Hong Kong Stock Exchange, New York Stock Exchange or National Association of Securities Dealers Automated Quotations ("**NASDAQ**") that has been registered under the applicable securities laws with the Group's valuation reaching a certain amount, or in a similar public offering of such shares or other equity securities in another jurisdiction which results in such shares or other equity securities trading publicly on a recognized regional or national securities exchange, provided, however, that such offering satisfies the foregoing valuation requirement and that the regulatory approval of such other jurisdiction and securities exchange is reasonably similar to that of Hong Kong Stock Exchange, New York Stock Exchange or NASDAQ as mutually determined by the majority investors and the Company.

(c) Redemption feature

At any time commencing on the redemption start date of December 23, 2019, at the option of a holder of the Preferred Shares (other than Series F) or the option of the holders of a majority of the then issued and outstanding Series F Preferred Shares (on an as converted basis), the Company shall redeem all, but not less than all, of the issued and outstanding Preferred Shares held by the requesting holders as elected by such holders out of funds legally available therefore including capital.

The redemption price shall be paid by the Company to the Preferred Shares holders in amount equal to the greater of (i) and (ii) below: (i) one hundred percent (100%) of the issue price on each Preferred Share, plus an eight percent (8%) per annum compound interest of the issue price on each Preferred Share accrued during the period from the issue date of each Preferred Share until the date stated on redemption notice on which the Preferred Shares are to be redeemed, and any declared but unpaid dividends thereon; (ii) the fair market value of such Preferred Share, the valuation of which shall be determined through an independent appraisal performed by an appraiser selected jointly by the board and the supermajority investors, provided that such valuation shall not take into account any liquidity or minority interest discounts.

35 Convertible redeemable preferred shares (continued)

(d) Liquidation preferences

In the event of any liquidation, dissolution or winding up of the Company, either voluntary or involuntary, distributions to the members of the Company shall be made in the following manner (after satisfaction of all creditors' claims and claims that may be preferred by law):

Each holder of Preferred Shares shall be entitled to receive for each series of Preferred Shares he or it holds on the preferential basis, prior and in preference to any distribution of any of the assets or surplus funds of the Company to the holders of other series of Preferred Shares and ordinary shares or any other class or series of shares by reason of their ownership of such shares, the amount equal to one hundred percent (100%) of the respective applicable issue price, plus accrued or declared but unpaid dividends for holders of Series E Preferred Shares, Series D Preferred Shares, certain Series C Preferred Shares, certain Series B Preferred Shares and certain Series A Preferred Shares, respectively, or one hundred and ten percent (110%) of the respective applicable issue price, plus accrued or declared but unpaid dividends for holders of the series of Preferred Shares other than those aforementioned. If the assets and funds available for distribution shall be insufficient to permit the payment to such holders of the full preferred preference amount, the liquidation preference amount will be paid to the holders of Preferred Shares in the following order: first to holders of Series F Preferred Shares, second to holders of Series E Preferred Shares, third to holders of Series D Preferred Shares, fourth to Series C Preferred shares, fifth to Series B Preferred shares and lastly to holders of Series A Preferred Shares. After distributing or paying in full the liquidation preference amount to all of the holders of Preferred Shares, the remaining assets of the Company available for distribution to members, if any, shall be distributed to the holders of the Preferred Shares and ordinary shares on a pro rata basis, based on the number of ordinary shares then held by each holder on an as-converted basis.

The Group does not bifurcate any embedded derivatives from the host instruments and designates the entire instruments as financial liabilities at fair value through profit or loss with the changes in the fair value recorded in the consolidated income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares (continued)

The movement of the convertible redeemable preferred shares is set out as below:

	RMB'000
At January 1, 2018	**161,451,203**
Changes in fair value	**(12,514,279)**
Currency translation differences	**2,163,584**
Conversion into ordinary shares	**(151,100,508)**
At December 31, 2018	**—**
At January 1, 2017	115,802,177
Issuance of Series F1 Preferred Shares	89,214
Changes in fair value	54,071,603
Currency translation differences	(8,511,791)
At December 31, 2017	161,451,203

Prior to the completion of IPO on July 9, 2018, the Group has used the discounted cash flow method to determine the underlying share value of the Company and adopted equity allocation model to determine the fair value of the Preferred Shares as of the dates of issuance and at the end of each reporting period.

(Expressed in RMB unless otherwise indicated)

35 Convertible redeemable preferred shares (continued)

Key valuation assumptions used to determine the fair value of Preferred Shares are as follows:

	As of December 31, 2017
Discount rate	17.00%
Risk-free interest rate	2.42%–2.61%
DLOM	10.00%
Volatility	30.76%–33.05%

Discount rate (post-tax) was estimated by weighted average cost of capital as of each valuation date. The Group estimated the risk-free interest rate based on the yield of US Government Bond with maturity life close to the QPO timing as of valuation date plus country risk spread. The DLOM was estimated based on the option-pricing method. Under option-pricing method, the cost of put option, which can hedge the price change before the private held share can be sold, was considered as a basis to determine the lack of marketability discount. Volatility was estimated based on annualized standard deviation of daily stock price return of comparable companies for a period from the respective valuation date and with similar span as time to expiration. Probability weight under each of the conversion feature, redemption feature and liquidation preferences was based on the Group's best estimates. In addition to the assumptions adopted above, the Company's projections of future performance were also factored into the determination of the fair value of Preferred Shares on each valuation date.

On July 9, 2018, the Company has successfully listed on the Main Board of the Stock Exchange and made an offering of 2,179,585,000 Class B ordinary shares (excluding any Class B ordinary shares issued pursuant to the exercise of the over-allotment option) at a price at HK$17.00 per share. All Preferred Shares were converted into Class B ordinary shares upon completion of the IPO on July 9, 2018. The fair value of each of Preferred Share on the conversion date is the Offer Price in the Global Offering.

Changes in fair value of Preferred Shares were recorded in "fair value changes of convertible redeemable preferred shares". Management considered that fair value changes in the Preferred Shares that are attributable to changes of credit risk of this liability are not significant.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

36 Cash flow information

(a) Cash generated from operations

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Profit/(loss) before income tax	**13,927,124**	(41,829,352)
Adjustments for:		
— Depreciation of property and equipment	219,523	166,515
— Amortization of intangible assets	528,693	194,441
— Gain on disposal of property and equipment	(10,295)	(513)
— Provision for impairment for trade and other receivables	33,211	16,965
— Impairment provision for loan receivables	607,180	258,470
— Impairment provision for inventories	3,006,525	652,560
— Interest income	(601,065)	(242,518)
— Interest expense	384,692	215,734
— Dividend income	(131,804)	(106,291)
— Share of losses of investments accounted for using the equity method	614,920	231,496
— Remeasurement of investments transferring from financial assets measured at fair value through profit or loss to investments accounted for using the equity method	(126,614)	—
— Net gains on disposals of long-term investments measured at fair value through profit or loss	(28,176)	(192,008)
— Gains on disposal of an investment accounted for using the equity method	—	(91,429)
— Fair value changes of convertible redeemable preferred shares	(12,514,279)	54,071,603
— Fair value gains on long-term investments measured at fair value through profit or loss	(4,430,359)	(6,371,098)
— Share-based compensation	12,380,668	909,155
— Foreign exchanges losses, net	14,550	144,265
— Investment income from short-term investments measured at fair value through profit or loss	(335,695)	(162,702)
— Investment income from short-term investments measured at amortized cost	(20,199)	(54,789)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

36 Cash flow information (continued)

(a) Cash generated from operations (continued)

	Year ended December 31, 2018 RMB'000	2017 RMB'000
Changes in working capital:		
— Increase in inventories	(16,114,975)	(8,617,146)
— Increase in trade receivables	(91,003)	(3,396,954)
— Increase in loan receivables	(2,752,183)	(6,856,767)
— Increase in prepayments and other receivables	(9,463,591)	(6,624,612)
— Decrease/(increase) in restricted cash	294,753	(1,788,284)
— Increase in trade payables	12,627,385	15,476,486
— Increase in advance from customers	1,050,583	1,554,508
— (Decrease)/increase in warranty provision	(51,600)	885,170
— Increase in other payables and accruals	1,118,058	2,056,983
— (Decrease)/increase in other non-current liabilities	(13,856)	27,433
Cash generated from operations	122,171	527,321

(b) Proceeds from disposal of property and equipment

In the consolidated statement of cash flows, proceeds from sale of property and equipment comprise:

	Year ended December 31, 2018 RMB'000	2017 RMB'000
Net book amount (Note 16)	17,072	1,018
Gain on disposal of property and equipment	10,295	513
Proceeds from disposal of property and equipment	27,367	1,531

(c) Non-cash transactions

Other than the share based awards described in Note 28, the reclassification of the investment in associates measured at fair value through profit or loss to investment accounted for using the equity method as described in Note 12(b), the conversion of convertible redeemable preferred shares described in Note 35 and the issuance of Class B ordinary shares as consideration in exchange for certain indirect equity interests in Timi Personal Computing Co., Ltd. described in Note 25, there were no material non-cash transactions for the year ended December 31, 2018 (2017: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

36 Cash flow information (continued)

(d) Reconciliation of liabilities generated from financing activities

	Liabilities from financing activities				
	Borrowing due within 1 year RMB'000	Borrowing due after 1 year RMB'000	Convertible redeemable preferred shares RMB'000	Interest payable RMB'000	Total RMB'000
Liabilities from financing activities as of January 1, 2018	3,550,801	7,251,312	161,451,203	5,742	172,259,058
Cash flows	(5,928,062)	5,691,840	—	(243,966)	(480,188)
Accrued interest expenses	—	—	—	334,416	334,416
Fair value changes of convertible redeemable preferred shares	—	—	(12,514,279)	—	(12,514,279)
Foreign exchange adjustments	(14,290)	418,950	2,163,584	—	2,568,244
Conversion of Preferred Shares to ordinary shares	—	—	(151,100,508)	—	(151,100,508)
Reclassification from non-current to current	5,466,745	(5,466,745)	—	—	—
Others	—	(39,214)	—	—	(39,214)
Liabilities from financing activities as of December 31, 2018	3,075,194	7,856,143	—	96,192	11,027,529
Liabilities from financing activities as of January 1, 2017	3,768,500	390,000	115,802,177	3,489	119,964,166
Cash flows	(338,406)	6,982,019	67,573	(146,378)	6,564,808
Accrued interest expenses	—	—	—	148,631	148,631
Fair value changes of convertible redeemable preferred shares	—	—	54,071,603	—	54,071,603
Foreign exchange adjustments	—	—	(8,511,791)	—	(8,511,791)
Reclassification from non-current to current	120,707	(120,707)	—	—	—
Others	—	—	21,641	—	21,641
Liabilities from financing activities as of December 31, 2017	3,550,801	7,251,312	161,451,203	5,742	172,259,058

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

37 Contingencies

The Group did not have any material contingent liabilities as of December 31, 2018 and 2017.

38 Commitments

(a) Capital commitments

Capital expenditure contracted for at the end of the years but not yet incurred is as follows:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Property and equipment	1,825,343	1,486,029
Intangible assets	57,778	112,888
Investments	137,176	198,788
	2,020,297	1,797,705

(b) Operating lease commitments

The Group leases offices and servers under non-cancellable operating lease agreements. The lease terms are between 1 to 7 years, and majority of lease agreements are renewable at the end of the lease at market rate.

The Group's future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
Not later than 1 year	560,926	258,230
Later than 1 year and not later than 5 years	385,038	280,613
Later than 5 years	83,276	—
	1,029,240	538,843

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operational decisions. Parties are also considered to be related if they are subject to common control. Members of key management and their close family members of the Group are also considered as related parties.

Save as disclosed in Note 22 and Note 31, the following significant transactions were carried out between the Group and its related parties during the years presented. In the opinion of the directors of the Company, the related party transactions were carried out in the normal course of business and at terms negotiated between the Group and the respective related parties.

(a) Names and relationships with related parties

The following companies are significant related parties of the Group that had transactions and/or balances with the Group during the year.

Company	Relationship
Beijing Kingsoft Cloud Technology Co., Ltd.	Associate of the Group
Beijing Kingsoft Internet Security Software Co., Ltd. (Note (b))	Associate of Lei Jun
Suzhou Industrial Park Shunwei Technology Venture Capital Partnership (Limited Partnership)	Controlled by a director
Zhuhai Xishanju Mobile Technology Co., Ltd.	Associate of the Group
Qingdao Yeelink Information Technology Co., Ltd. (Note (a))	Associate of the Group
Beijing Fengmi Technology Co., Ltd. (Note (a))	Associate of the Group
Beijing Miiiw Technology Co., Ltd. (Note (a))	Associate of the Group
Nanjing Jiqidao Smart Technology Co., Ltd.	Associate of the Group
Shanghai Chuangmi Technology Co., Ltd. (Note (a))	Associate of the Group
Shanghai Chunmi Electronic Technology Co., Ltd. (Note (a))	Associate of the Group
Shanghai Xiaoxun Technology Co., Ltd. (Note (a))	Associate of the Group
Wuxi Roidmi Co., Ltd. (Note (a))	Associate of the Group
Beijing Yuemi Technology Co., Ltd.	Associate of the Group
Ximalaya Inc. (Note (a))	Associate of the Group
Beijing Roborock Technology Co., Ltd.	Associate of the Group
Shanghai Runmi Technology Co., Ltd. (Note (a))	Associate of the Group
Banya Information Technology (Shanghai) Co., Ltd. (Note (a))	Associate of the Group

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(a) Names and relationships with related parties (continued)

Company	Relationship
Sichuan Xin Wang Bank Co., Ltd. (Note 12(b))	Associate of the Group
Dongguan Powerise Fashion Technology Co., Ltd. (Note (a))	Associate of the Group
Turok Steinhardt (Beijing) Optical Technology Co., Ltd. (Note (a))	Associate of the Group
Qiji (Xiamen) Technology Co., Ltd. (Note (a))	Associate of the Group
Tianjin Hualai Technology Co., Ltd. (Note (a))	Associate of the Group
Shenzhen ShowmePlus Technology Co., Ltd. (Note (a))	Associate of the Group
Soocare (Shenzhen) Technology Co., Ltd. (Note (a))	Associate of the Group
Ningxia Raycom Technology Development Co., Ltd. (Note (a))	Associate of the Group
Longcheer Technology (Huizhou) Co., Ltd.	Associate of the Group
ChingMi (Beijing) Technology Co., Ltd. (Note (a))	Associate of the Group
Shanghai Longcheer Technology Co., Ltd.	Associate of the Group
Longcheer Communication Technology (HK) Co., Ltd.	Associate of the Group
Beijing iQIYI Science & Technology Co., Ltd. (Note (12(b))	Associate of the Group
Beijing Particle Information Technology Co., Ltd. (Note (a))	Associate of the Group
Shenzhen Lumi Technology Co., Ltd. (Note (a))	Associate of the Group
Beijing SmartMi Electronic Technology Co., Ltd. (Note (a))	Associate of the Group
Anhui Huami Information Technology Co., Ltd. (Note 12(b))	Associate of the Group
Jiangsu Zimi Electronic Technology Co., Ltd. (Note (a))	Associate of the Group
Ninebot Limited (Note (a))	Associate of the Group
Foshan Yunmi Electrical Technology Co., Ltd. (Note (12(b))	Associate of the Group
Zimi Communication Technology (Jiangsu) Co., Ltd. (Note (a))	Associate of the Group
Shenzhen Pineapple Games Co., Ltd. (Note (a))	Associate of the Group
FiMi United Technology Limited (Note (a))	Associate of the Group
Shanghai Pineapple Entertainment Technology Co., Ltd. (Note (a))	Associate of the Group
Eryihao Acoustics Science & Technology (Shenzhen) Co., Ltd. (Note (a))	Associate of the Group
1 More Acoustics Science & Technology (Shenzhen) Co., Ltd. (Note (a))	Associate of the Group
Viomi Technology Co., Ltd. (Note 12(b))	Associate of the Group
Nanchang Blackshark Technology Co., Ltd.	Associate of the Group
Seasun Entertainment Co., Ltd.	Associate of the Group
Forewin Suzhou Electronics Co., Ltd. (Note (a))	Associate of the Group

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(a) Names and relationships with related parties (continued)

Company	Relationship
Luokeshidai Technology (Shenzhen) Co., Ltd. (Note (a))	Associate of the Group
Guolong Information Technology (Shanghai) Co., Ltd.	Associate of the Group
Liesheng Technology (Dongguan) Co., Ltd. (Note (a))	Associate of the Group
Feihui Smart Lighting (Shanghai) Co., Ltd.	Associate of the Group
Miaobo Software Technology (Shanghai) Co., Ltd.	Associate of the Group
Tianjin Smate Technology Co., Ltd. (Note (a))	Associate of the Group
Beijing iHealth Technology Co., Ltd. (Note (a))	Associate of the Group
Rice Sugar Culture Creative Co., Ltd. (Note (a))	Associate of the Group
XiaoHou Technology Co., Ltd. (Note (a))	Associate of the Group
Inso Technology Co., Ltd. (Note (a))	Associate of the Group
QingHeXiaoBei (Wuxi) Inc.	Associate of the Group
LeXiu Technology (Hangzhou) Co., Ltd. (Note (a))	Associate of the Group
Chunmi Technology (Wuhu) Co., Ltd. (Note (a))	Associate of the Group
Beijing Xiaomi Insurance Co., Ltd.	Associate of the Group
Shunwei Ventures II (Hong Kong) Limited	Controlled by a director
Beijing MADV Technology Co., Ltd. (Note (a))	Associate of the Group
Beijing ClearGrass Technology Co., Ltd. (Note (a))	Associate of the Group

Notes:

(a) The Group's investments were made in the form of ordinary shares with preferential rights or convertible redeemable preferred shares which are accounted as financial assets measured at fair value through profit or loss.

(b) Since March 13, 2018, the Group has ceased to be a related party with Beijing Kingsoft Internet Security Software Co., Ltd., subsidiaries of Cheetah Mobile Inc. as Lei Jun resigned as the Chairman and a member of the Board of Cheetah Mobile Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(b) Significant transactions with related parties

	Year ended December 31, 2018 RMB'000	2017 RMB'000
(i) Sales of goods and services		
Associates of the Group	1,153,491	704,476
Associates of Lei Jun	25,376	61,456
	1,178,867	765,932
(ii) Purchases of goods and services		
Associates of the Group	18,634,514	13,254,277
Associates of Lei Jun	14,768	686
	18,649,282	13,254,963

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(c) Year end balances with related parties

	As of December 31,	
	2018	2017
	RMB'000	RMB'000
(i) Trade receivables from related parties		
Associates of the Group	361,792	162,901
Associates of Lei Jun	2,816	25,715
	364,608	188,616
(ii) Trade payables to related parties		
Associates of the Group	4,004,778	3,204,190
Associates of Lei Jun	1,916	4,572
	4,006,694	3,208,762
(iii) Other receivables from related parties		
Associates of the Group	243,126	177,831
Controlled by a director	—	4,000
	243,126	181,831
(iv) Other payables to related parties		
Associates of the Group	770,032	416,348
Controlled by a director	76,966	—
Associates of Lei Jun	7,652	8,202
	854,650	424,550
(v) Prepayments		
Associates of the Group	88,289	67,336

All the balances with related parties above were unsecured and repayable within one year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(d) Loans to related parties

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Loans to associates:		
At the beginning of the year	62,143	74,329
Loans advanced	50,000	1,500
Loans repaid	(103,116)	(14,000)
Interest charged	1,921	3,481
Interest received	(2,210)	(1,845)
Currency translation differences	(759)	(1,322)
At the end of the year	7,979	62,143

(e) Loans from related parties

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Loans from associates:		
At the beginning of the year	51,336	50,873
Loans repaid	(50,958)	—
Interest charged	146	463
Interest paid	(855)	—
Currency translation differences	331	—
At the end of the year	—	51,336

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

39 Related party transactions (continued)

(f) Key management compensation

	Year ended December 31,	
	2018	2017
	RMB'000	RMB'000
Salaries	15,124	6,113
Discretionary bonuses	1,200	9,550
Share-based compensation	10,464,196	186,095
Employer's contribution to pension schedule	989	1,067
	10,481,509	202,825

40 Events after the reporting period

The Company repurchased 6,140,000, 9,849,600 and 3,982,600 Class B ordinary shares of the Company on January 17, 2019, January 18, 2019 and January 22, 2019, representing approximately 0.026%, 0.041% and 0.017% of the issued total share capital of the Company as at the respective transaction days. The total considerations were approximately HK$59,942,000, HK$100,000,000 and HK$39,989,000, respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

41 Financial position and reserve movement of the Company

(a) Financial position of the Company

	As of December 31, 2018 RMB'000	2017 RMB'000
Assets		
Non-current assets		
Property and equipment	35	33
Investment in subsidiaries	13,434,702	5,815,295
Other assets	77	73
	13,434,814	5,815,401
Current assets		
Prepayments and other receivables	30,217,183	7,550,122
Cash and cash equivalents	5,707	2,131
	30,222,890	7,552,253
Total assets	43,657,704	13,367,654
Equity and liabilities		
Equity attributable to owners of the Company		
Share capital	377	150
Reserves	39,159,983	(149,322,405)
Total equity	39,160,360	(149,322,255)
Liabilities		
Non-current liabilities		
Convertible redeemable preferred shares	—	161,451,203
	—	161,451,203
Current liabilities		
Other payables and accruals	4,497,344	1,238,706
	4,497,344	1,238,706
Total liabilities	4,497,344	162,689,909
Total equity and liabilities	43,657,704	13,367,654

The balance sheet of the Company was approved by the Board of Directors on March 19, 2019 and was signed on its behalf:

Lei Jun
Director

Lin Bin
Director

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

41 Financial position and reserve movement of the Company (continued)

(b) Reserve movement of the Company

	Share premium RMB'000	Share-based compensation reserve RMB'000	Currency translation differences RMB'000	Capital reserve RMB'000	Others RMB'000	Subtotal RMB'000	Accumulated losses RMB'000	Total RMB'000
At January 1, 2018	742,760	3,816,153	(3,495,173)	25,950	9,392	1,099,082	(150,421,487)	(149,322,405)
Issuance of ordinary shares	9,827,146	–	–	–	–	9,827,146	–	9,827,146
Issuance of ordinary shares relating to initial public offering, net of underwriting commissions and other issuance costs	23,248,593	–	–	–	–	23,248,593	–	23,248,593
Release of ordinary shares from Share Scheme Trusts	933,592	(841,640)	–	–	–	91,952	–	91,952
Conversion of Preferred Shares to ordinary shares	151,100,334	–	–	–	–	151,100,334	–	151,100,334
Employees share-based compensation scheme: – value of employee services (Note 28)	–	2,461,525	–	–	–	2,461,525	–	2,461,525
Acquisition of additional equity interests in non wholly owned subsidiaries	230,899	–	–	–	–	230,899	–	230,899
Currency translation differences (Note (a))	–	–	(1,098,818)	–	–	(1,098,818)	–	(1,098,818)
Share premium set off the accumulated losses and other reserves	(142,232,042)	–	5,579,472	–	–	(136,652,570)	136,652,570	–
Profit for the year	–	–	–	–	–	–	2,620,757	2,620,757
At December 31, 2018	43,851,282	5,436,038	985,481	25,950	9,392	50,308,143	(11,148,160)	39,159,983

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in RMB unless otherwise indicated)

41 Financial position and reserve movement of the Company (continued)

(b) Reserve movement of the Company (continued)

	Share premium RMB'000	Share-based compensation reserve RMB'000	Currency translation differences RMB'000	Capital reserve RMB'000	Others RMB'000	Subtotal RMB'000	Accumulated losses RMB'000	Total RMB'000
At January 1, 2017	742,760	3,008,259	(11,549,446)	13,662	16,466	(7,768,299)	(96,219,976)	(103,988,275)
Employees share-based compensation scheme:								
– value of employee services (Note 28)	–	807,894	–	–	–	807,894	–	807,894
Share of other comprehensive loss of investments accounted for using the equity method	–	–	–	–	(7,074)	(7,074)	–	(7,074)
Share of other reserves of investments accounted for using the equity method	–	–	–	12,288	–	12,288	–	12,288
Currency translation differences (Note (a))	–	–	8,054,273	–	–	8,054,273	–	8,054,273
Loss for the year	–	–	–	–	–	–	(54,201,511)	(54,201,511)
At December 31, 2017	742,760	3,816,153	(3,495,173)	25,950	9,392	1,099,082	(150,421,487)	(149,322,405)

Note:

(a) Foreign Currency translation reserve represents the difference arising from the translation of the financial statements of the Company as its functional currency in US$, different from its presentation currency as RMB.

DEFINITIONS

"affiliate"	with respect to any specified person, any other person, directly or indirectly, controlling or controlled by or under direct or indirect common control with such specified person
"Articles" or "Articles of Association"	the articles of association of the Company adopted on June 17, 2018 with effect from Listing, as amended from time to time
"associate(s)"	has the meaning ascribed to it in the Listing Rules
"Auditor"	PricewaterhouseCoopers, the external auditor of the Company
"Beijing Digital Technology"	Beijing Xiaomi Digital Technology Co., Ltd.* (北京小米數碼科技有限公司), a limited liability company established under the laws of mainland China on December 21, 2010 and our indirect wholly-owned subsidiary
"Beijing Duokan"	Beijing Doukan Technology Co., Ltd.* (北京多看科技有限公司), a limited liability company established under the laws of mainland China on February 10, 2010 and our Consolidated Affiliated Entity
"Beijing Electronic Software"	Beijing Xiaomi Electronic Software Co., Ltd.* (北京小米電子軟件技術有限公司), a limited liability company established under the laws of mainland China on July 1, 2014 and our Consolidated Affiliated Entity
"Beijing Wali Culture"	Beijing Wali Culture Communication Co., Ltd.* (北京瓦力文化傳播有限公司), a limited liability company established under the laws of mainland China on May 8, 2014 and our Consolidated Affiliated Entity
"Beijing Wali Internet"	Beijing Wali Internet Technologies Co., Ltd.* (北京瓦力網絡科技有限公司), a limited liability company established under the laws of mainland China on June 1, 2009 and our Consolidated Affiliated Entity

"Beijing Wenmi"	Beijing Wenmi Culture Co., Ltd* (北京文米文化有限公司), a limited liability company established under the laws of mainland China on December 28, 2016 and our wholly-owned subsidiary
"Board"	our Board of Directors
"CG Code"	the Corporate Governance Code and Corporate Governance Report set out in Appendix 14 of the Listing Rules
"Class A Shares"	class A ordinary shares of the share capital of the Company with a par value of US$0.0000025 each, conferring weighted voting rights in the Company such that a holder of a Class A Share is entitled to ten votes per share on any resolution tabled at the Company's general meetings, save for resolutions with respect to any Reserved Matters, in which case they shall be entitled to one vote per share
"Class B Shares"	class B ordinary shares of the share capital of the Company with a par value of US$0.0000025 each, conferring a holder of a Class B Share one vote per share on any resolution tabled at the Company's general meetings
"Co-founder"	Hong Feng, Li Wanqiang, Lin Bin, Liu De, Wang Chuan, Wong Kong Kat and Zhou Guangping
"Companies Ordinance"	the Companies Ordinance (Chapter 622 of the Laws of Hong Kong), as amended, supplemented or otherwise modified from time to time
"Company", "our Company", or "the Company"	Xiaomi Corporation 小米集团 (formerly known as Top Elite Limited), a company with limited liability incorporated under the laws of the Cayman Islands on January 5, 2010
"connected person(s)"	has the meaning ascribed to it in the Listing Rules

DEFINITIONS

"connected transaction(s)"	has the meaning ascribed to it in the Listing Rules
"Consolidated Affiliated Entities", each a "Consolidated Affiliated Entity"	the entities we control through the Contractual Arrangements, namely the Onshore Holdcos and their respective subsidiaries
"Contractual Arrangements"	the set of agreements that entered into by each of the WFOEs and the Onshore Holdcos for the purpose of operations of the Restricted Business of the Group in the PRC
"Controlling Shareholder(s)"	has the meaning ascribed thereto under the Listing Rules and unless the context otherwise requires, refers to Lei Jun and the directly and indirectly held companies through which Lei Jun has an interested in the Company, namely, Smart Mobile Holdings Limited and Smart Player Limited
"Director(s)"	the director(s) of the Company
"Group", "our Group", or "the Group"	the Company, its subsidiaries and the PRC Operating Entities (the financial results of which have been consolidated and accounted for as a subsidiary of the Company by virtue of the Contractual Arrangements) from time to time
"Hong Kong" or "HK"	the Hong Kong Special Administrative Region of the People's Republic of China
"Hong Kong dollars" or "HK dollars" or "HK$"	Hong Kong dollars, the lawful currency of Hong Kong
"Listing"	the listing of the Class B Shares on the Main Board of the Stock Exchange
"Listing Date"	July 9, 2018, the date on which the Shares were listed on the Stock Exchange
"Listing Rules"	the Rules governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, as amended, supplemented or otherwise modified from time to time

"Main Board"	the stock exchange (excluding the option market) operated by the Stock Exchange which is independent from and operates in parallel with GEM of the Stock Exchange
"Model Code"	the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Listing Rules
"Onshore Holdcos" each a "Onshore Holdco"	(i) Beijing Wali Culture, (ii) Rigo Design, (iii) Xiaomi Inc., (iv) Beijing Doukan, (v) Beijing Wali Internet, (vi) Xiaomi Pictures, (vii) Beijing Electronic Software and (viii) Youpin Information Technology
"Pinecone International"	Pinecone International Limited, an exempted company with limited liability incorporated under the laws of the Cayman Islands on November 7, 2014 and our indirect wholly-owned subsidiary
"Pinecone Share Option Scheme I"	the share option scheme adopted by Pinecone International on July 30, 2015 as amended from time to time
"Pinecone Share Option Scheme II"	the share option scheme adopted by Pinecone International on June 17, 2018 as amended from time to time
"Post-IPO Share Option Scheme"	the share option scheme adopted by the Company on June 17, 2018 as amended from time to time
"PRC"	the People's Republic of China
"PRC Legal Advisor"	JunHe LLP
"Pre-IPO ESOP"	the pre-IPO employee stock incentive scheme adopted by the Company on May 5, 2011 and superseded on August 24, 2012 as amended from time to time
"Prospectus"	the prospectus of the Company dated June 25, 2018

DEFINITIONS

"Registered Shareholders"	the registered shareholders of the Onshore Holdcos
"Reserved Matters"	those matters resolutions with respect to which each Share is entitled to one vote at general meetings of the Company pursuant to the Articles of Association, being (i) any amendment to the Memorandum or Articles, including the variation of the rights attached to any class of shares, (ii) the appointment, election or removal of any independent non-executive Director, (iii) the appointment or removal of the Company's auditors, and (iv) the voluntary liquidation or winding-up of the Company
"Rigo Design"	Rigo Design (Beijing) Co., Ltd.* (美卓軟件設計（北京）有限公司), a limited liability company established under the laws of mainland China on April 24, 2012 and our Consolidated Affiliated Entity
"RMB" or "Renminbi"	Renminbi, the lawful currency of mainland China
"SFO"	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), as amended, supplemented or otherwise modified from time to time
"Share Award Scheme"	the share award scheme adopted by the Company on June 17, 2018
"Share(s)"	the Class A Shares and/or Class B Shares in the share capital of the Company, as the context so requires
"Shareholder(s)"	holder(s) of the Share(s)
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"subsidiary(ies)"	has the meaning ascribed to it in section 15 of the Companies Ordinance
"substantial shareholder"	has the meaning ascribed to it in the Listing Rules

"Tianjin Commercial Factoring"	Xiaomi Commercial Factoring (Tianjin) Co., Ltd* (小米商業保理(天津)有限責任公司), a limited liability company established under the laws of mainland China on March 21, 2018 and our indirect wholly-owned subsidiary
"United States" or "US"	the United States of America, its territories, its possessions and all areas subject to its jurisdiction
"US$"	United States dollars, the lawful currency of the United States
"weighted voting rights"	has the meaning ascribed to it in the Listing Rules
"WFOEs", each a "WFOE"	Beijing Baien, Xiaomi Mobile Software, Beijing Wenmi, Beijing Digital Technology, Tianjin Commercial Factoring, Beijing Wali, Xiaomi Communications and Xiaomi Youpin Technology
"WVR Beneficiary"	has the meaning ascribed to it in the Listing Rules
"Xiaomi Communications"	Xiaomi Communications Co., Ltd* (小米通訊技術有限公司), a limited liability company established under the laws of mainland China on August 25, 2010 and our indirect wholly-owned subsidiary
"Xiaomi Finance"	Xiaomi Finance Inc., an exempted company with limited liability incorporated under the laws of the Cayman Islands on February 15, 2018 and our direct wholly-owned subsidiary
"Xiaomi Inc."	Xiaomi Inc.* (小米科技有限責任公司), a limited liability company established under the laws of mainland china on March 3, 2010 and our Consolidated Affiliated Entity
"Xiaomi Pictures"	Xiaomi Pictures Co., Ltd.* (小米影業有限責任公司), a limited liability company established under the laws of mainland China on June 7, 2016 and our Consolidated Affiliated Entity

DEFINITIONS

"Xiaomi Youpin Technology"	Xiaomi Youpin Technology Co. Ltd.* (小米有品科技有限公司), a limited liability company established under the laws of mainland China on May 8, 2018 and our indirect wholly-owned subsidiary
"XMF Share Option Scheme I"	the first share option scheme adopted by Xiaomi Finance on June 17, 2018, as amended from time to time
"XMF Share Option Scheme II"	the second share option scheme adopted by Xiaomi Finance on June 17, 2018
"%"	per cent

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